

American Tax Club, Inc.
(AMERITAX)

2024

Annual Federal Tax Refresher (AFTR) Course

Annual Filing Season Program
(AFSP)



Presentation

Welcome to our Annual Filing Tax Refresher Course (AFTRC) for 2024.

This course is part of the requirements to participate in the Annual Filing Season Program (AFSP) with the Internal Revenue Service (IRS). It is a voluntary program designated for tax professionals who do not have other credentials. Although the program has limitations, it is a great opportunity for growth and public exposure for tax professionals across the country.

You must complete the six (6) hour course before taking the final exam and thus obtain the certificate that will allow you to participate in the AFSP and thus be included in the IRS public directory.

At Ameritax we are committed to offering you an educational offer of excellence.

Welcome to the Ameritax© Educational Experience.

Sincerely.

Luis Parra, EA

Executive Director

Dear Professional,

It is my honor to welcome you to this year's Annual Filing Season Program (AFSP). As the Education Director for Ameritax, I want to ensure that you have all the information and support you need to get the most out of this program.

The material you will receive is a comprehensive tool, designed specifically for your preparation for the AFSP. This material will provide you with a solid and up-to-date understanding of tax regulations, adequately preparing you for the 2024 filing season. I encourage you to review it carefully and use it as your primary study resource.

Your participation in the AFSP not only demonstrates your commitment to continuing education but is also critical to maintaining high standards of professionalism in our industry.

Sincerely,

Odalys Parra, EA, CAA

Education Director

DISCLAIMER

In Ameritax we have dedicated time and care to the elaboration of this content to offer you correct and updated information, we cannot guarantee that the information is correct or that it is appropriate to your particular situation.

You are responsible for using this material under this premise.

This content is only to support you in preparing for the 2024 Annual Filing Tax Refresh Course (AFTRC).

All the information in this content is in reference to December 31,2023 and can be found on the website: [irs.gov](https://www.irs.gov)

Annual Filing Season Program (AFSP)

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Domain 1 – New Tax Law and Recent Updates

Domain 1 of the Annual Federal Tax Refresher (AFTR) course covers new tax law and recent updates for the 2024 filing season.

Objectives

Domain 1 of the course reviews important tax law changes and updates. It is important for tax return preparers to review changes and updates each year to prepare accurate returns for taxpayers.

The objectives of Domain 1 are to:

- o Annual inflation and cost of living adjustments (Rev. Proc. 2023-34)
- o New standard mileage rates (Notice 2024-08)
- o Third Party Network Transactions (Form 1099-K) reporting requirements (FS-2023-27) (Notice 2024-33)
- o Resume issuing automated reminder notices for balances due for taxable years 2021 and earlier (Notice 2024-07)
- o Direct File Pilot Program ([Directfile.irs.gov](https://directfile.irs.gov))
- o SECURE 2.0 Act, Section 325, Roth plan distribution rules effective for 2024
- o SECURE 2.0 Act, Section 603, Catch-up Contributions effective for 2024

1.1 Annual Inflation Adjustments

Each year, the Internal Revenue Service (IRS) adjusts more than 40 tax provisions, including tax rate schedules, exemption amounts, filing thresholds, and other tax changes for inflation. This helps taxpayers so they are not pushed into a higher tax bracket due to inflation.

For tax year 2024, Revenue Procedure 2023-34 provides details about these adjustments.

Individual Tax Rates – Single [Unmarried Individuals (other than Surviving Spouse and Heads of Household)]

For tax year 2024, the tax rates for individuals filing as “Single” are shown in the table below.

If Taxable Income is:	The Tax is:
Not over \$11,600	10% of the taxable income
Over \$11,600 but not over \$47,150	\$1,160 plus 12% of the excess over \$11,600
Over \$47,150 but not over \$100,525	\$5,426 plus 22% of the excess over \$47,150
Over \$100,525 but not over \$191,950	\$17,168.50 plus 24% of the excess over \$100,525
Over \$191,950 but not over \$243,725	\$39,110.50 plus 32% of the excess over \$191,950
Over \$243,725 but not over \$609,350	\$55,678.50 plus 35% of the excess over \$243,725

Over \$609,350	\$183,647.25 plus 37% of the excess over \$609,350
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Individual Tax Rates - Head of Household

For tax year 2024, the tax rates for individuals filing as “Head of Household” are shown in the table below.

If Taxable Income is:	The Tax is:
Not over \$16,550	10% of the taxable income
Over \$16,550 but not over \$63,100	\$1,665 plus 12% of the excess over \$16,550
Over \$63,100 but not over \$100,500	\$7,241 plus 22% of the excess over \$63,100
Over \$100,500 but not over \$191,950	\$15,469 plus 24% of the excess over \$100,500
Over \$191,950 but not over \$243,700	\$37,417 plus 32% of the excess over \$191,950
Over \$243,700 but not over \$609,350	\$53,977 plus 35% of the excess over \$243,700
Over \$609,350	\$181,954.50 plus 37% of the excess over \$609,350

Individual Tax Rates – Married Filing Jointly

For tax year 2024, the tax rates for married individuals filing joint returns are shown in the table below. This chart also applies to individuals filing as a “Surviving Spouse.”

If Taxable Income is:	The Tax is:
Not over \$23,200	10% of the taxable income
Over \$23,200 but not over \$94,300	\$2,2320 plus 12% of the excess over \$23,200
Over \$94,300 but not over \$201,500	\$10,852 plus 22% of the excess over \$94,300
Over \$201,050 but not over \$383,900	\$34,337 plus 24% of the excess over \$201,050
Over \$383,900 but not over \$487,450	\$78,221 plus 32% of the excess over \$383,900
Over \$487,450 but not over \$731,200	\$111,357 plus 35% of the excess over \$487,450
Over \$731,200	\$196,669.50 plus 37% of the excess over \$731,200

Individual Tax Rates – Married Filing Separately

For tax year 2024, the tax rates for married individuals filing separate returns are shown in the table below.

If taxable income is:	The Tax is:
Not over \$11,600	10% of the taxable income
Over \$11,600 but not over \$47,150	\$1,160 plus 12% of the excess over \$11,600
Over \$47,150 but not over \$100,525	\$5,426 plus 22% of the excess over \$47,150
Over \$100,525 but not over \$191,950	\$17,168.50 plus 24% of the excess over \$100,525
Over \$191,950 but not over \$243,725	\$39,110.50 plus 32% of the excess over \$191,950
Over \$243,725 but not over \$365,600	\$55,678.50 plus 35% of the excess over \$243,725
Over \$365,000	\$98,334.75 plus 37% of the excess over \$365,000

Individual Tax Rates – Estates and Trusts

For the tax year 2024, the tax rates for estates and trusts are shown in the table below.

Taxable Income	Tax Rate
Not over \$3,100	10% of the taxable income
Over \$3,100 but not over \$11,150	\$310 plus 24% of the excess over \$3,100
Over \$11,150 but not over \$15,250	\$2,242 plus 35% of the excess over \$11,150
Over \$15,250	\$3,659.50 plus 37% of the excess over \$15,200

Capital Gains Tax Rates

Long-term capital gains rates have been indexed for the 2024 tax year. The 2024 long-term capital gains rates are shown in the table below.

Filing Status	Maximum Zero Rate Amount	Maximum 15% Rate Amount
Married Individuals Filing Joint Returns and Surviving Spouse	\$94,050	\$583,750
Married Individuals Filing Separate Returns	47,025	\$291,850
Heads of Household	\$63,000	\$551,350
All Other Individuals	\$47,025	\$518,901
Estates and Trusts	\$3,125	\$15,450

Unrecaptured §1250 real property gain is taxed at a maximum 25% rate.

The capital gain rate for §1202 qualified small business stock and collectibles remains at 28% for tax year 2024.

Filing Requirements

Residents and citizens of the U.S. generally must file a tax return based upon three factors:

- Gross Income
- Filing Status
- Age

Gross income includes all income received in the form of money, goods, property, and services that is not exempt from tax. Gross income also includes income from sources outside the United States.

The 2024 filing requirements are show in the table below:

Filing Status	Age at end of 2024	Return must be filed if gross income was at least
Single	Under 65	\$14,600
	65 or older	\$16,550
Married Filing Joint	Under 65 (both spouses)	\$29,200
	65 or older (one spouse)	\$30,750
	65 or older (both spouse)	\$32,300
Married Filing Separately	Any age	\$5
Head of Household	Under 65	\$21,900
	65 or older	\$23,850
Qualifying Surviving Spouse	Under 65	\$29,200
	65 or Older	\$30,750

Some exceptions:

- If a taxpayer can be claimed as a dependent of another, the income threshold is generally lower than gross income listed in the above table.
- Self-employed taxpayers must file a tax return (and pay SE tax) if net income is more than \$400.

- Special rules apply for dependent children with investment income and taxpayers who are blind.
- If any member of the tax household was enrolled in coverage through the Health Insurance Marketplace, the coverage will be reported on Form 1095-A and a tax return must be filed to reconcile the premium tax credit.

Standard Deduction

For 2024, the standard deduction amount has been raised for most taxpayers.

Filing Status	2024	2023
Single	\$14,600	\$13,850
Head of Household	\$21,900	\$20,800
Married Filing Jointly	\$29,200	\$27,700
Qualifying Surviving Spouse	\$29,200	\$27,700
Married Filing Separately	\$14,600	\$13,850

The standard deduction amount might be increased for taxpayers who are blind or age 65 or older.

Alternatively, taxpayers who can be dependents of another will have a reduction in their standard deduction.

The additional standard deduction for individuals 65 years or older, or blind, is:

- \$1,950 for taxpayers filing Single.
- \$1,950 for taxpayers filing Head of Household
- \$1,550 for taxpayers filing either Married Filing Jointly or as Qualifying Surviving Spouse

Standard Deduction for Dependents

The standard deduction for individuals who may be claimed as a dependent by another taxpayer cannot exceed the greater of:

- \$1,300
- Sum of earned income and \$450 (but not more than the regular standard deduction amount, generally \$14,600)

Example:

Amy, a high school student, is 17 years old and single. Her parents can claim her as a dependent on their 2024 federal tax return. Amy has a part-time job at a local bookstore and earned \$2,000 in wages for the year.

Considering that Amy is not blind, her standard deduction would be \$2,450 (\$450 + earned income of \$2,000).

Example:

Mike, age 18, is single and can be claimed as a dependent on his parents' 2024 federal tax return. During 2024, Mike worked part-time delivering food, earning \$250 for the year. He also earned \$1,500 in interest income.

Because Mike is not blind, his standard deduction for 2024 is \$1,300, which is greater than the sum of his earned income and \$450 ($\$250 + \$450 = \700). The interest income is not considered because it is not earned income.

Child Tax Credit

The Tax Cuts and Jobs Act of 2017 (TCJA) increased the amount of the Child Tax Credit and threshold amounts for phaseouts.

For tax years 2018 through 2025, the Child Tax Credit is increased from \$1,000 to \$2,000 per qualifying child under age 17; however, this Child Tax Credit is available only if the taxpayer provides a valid Social Security Number for the qualifying child on the tax return.

Threshold amounts at which the Child Tax Credit phaseout have been increased substantially. The phaseout amounts for tax years 2018 through 2025 are:

- \$400,000 MAGI for married taxpayers filing jointly.
- \$200,000 MAGI for all other filing statuses. These threshold amounts are not indexed for inflation.

The amount of the Child Tax Credit that is refundable is increased to \$1,700 per qualifying child for tax year 2024.

Earned Income Credit

The Earned Income Tax Credit (EITC) is a refundable credit that reduces or eliminates the taxes paid by low-income workers. To claim the credit, the taxpayers must have earned income less than \$66,819 during the year.

To claim the credit, the taxpayers must file a tax return even if they are not required to file or do not owe any tax and they meet all the rules for

taking the credits. For tax year 2024, many of the rules remain unchanged; however, the amounts used to determine eligibility, and the amount of the credit have changed.

Childless workers must be at least 25, but not 66 or older, to claim credit in 2024.

The following table shows the inflation adjustments for EITC for tax year 2024 as published in Rev. Proc. 2023-34:

ITEM	ONE	TWO	THREE O MORE	NONE
Earned Income Amount	\$12,390	\$17,400	\$17,400	\$8,260
Maximum Amount of Credit	\$4,213	\$6,960	\$7,830	\$632
Threshold Phaseout Amount (Single, Surviving Spouse, or Head of House)	\$22,720	\$22,720	\$22,720	\$10,330

Completed Phaseout Amount (Single, Surviving Spouse, or Head of House)	\$49,084	\$55,768	\$59,899	\$18,591
Threshold Phaseout Amount (Married Filing Jointly)	\$29,640	\$29,640	\$29,640	\$17,250
Completed Phaseout Amount (Married Filing Jointly)	\$56,004	\$62,688	\$66,819	\$25,511

The investment income limitation for tax year 2024 was increased by the ARPA. To claim EITC, taxpayers must have \$11,600 or less in investment income. For most taxpayers, investment income is the sum of taxable and tax-exempt interest, dividend income, and capital gain net income. If taxpayers file Schedule E, Form 4797, Form 8814, or report income on

Forms 1040 or 1040-SR, Schedule 1, line 8, for rental of personal property, review IRS Publication 596.

Adoption Credit

For tax year 2024, the maximum Adoption Credit has been raised to \$16,810 per qualifying child.

The amount of the Adoption Credit begins to be phased out when the 2024 modified adjusted gross income (MAGI) reaches \$252,150 and is eliminated at \$292,150.

More Annual Inflation Amounts

Many more items were adjusted for inflation.

1.2 New Standard Mileage Provisions (Notice 2024-08)

The IRS released Notice 2024-08 to provide rules for using standard mileage rates for calculating deductible expenses for automobile use for business, charitable, medical, and moving expenses.

Prior to Notice 2024-03, the IRS issued Rev. Proc. 2019-46 in November of 2019 to reflect provisions changed by the Tax Cuts and Jobs Act (TCJA).

Some of the key provisions that were updated at that time include:

- Taxpayers cannot claim a miscellaneous itemized deduction using the business standard mileage rate.
- Taxpayers cannot claim parking and tolls attributable to the taxpayer's use of an automobile for business purposes as a miscellaneous itemized deduction.

- Taxpayers must reduce the basis of automobiles used in business by the depreciation claimed or allowable for the automobile. If the business standard mileage rate is used, a per-mile amount will be considered to be depreciation claimed or allowable.
- Deductions for moving expenses are not allowed unless the taxpayer is a member of the Armed Forces on active duty moving pursuant to a military order and incident to a permanent change of station.

The 2024 mileage rate for business is 67.0 cents per mile.

The standard mileage rate for charitable miles is 14.0 cents per mile.

The standard mileage rate for medical purposes is 21.0 cents per mile.

Members of the Armed Forces on active duty who moved pursuant to a military order and incident to a permanent change of station can use the standard mileage rate of 21.0 cents per mile for moving expenses reported on Form 3903.

1.3 Third Party Network Transactions (Form 1099-K) – (Notice 2024-33)

A payment settlement entity (PSE) is a domestic or foreign entity that is a merchant acquiring entity. In other words, a PSE is a bank or other organization that has the contractual obligation to make payment to participating payees in settlement of payment card transactions; or a PSE can be a third-party settlement organization (TPSO), meaning a central organization that has the contractual obligation to make payments to participating payees of third-party network transactions. Examples include PayPal, Venmo, and Cash App, as well as other payment facilitators and marketplaces.

Examples include PayPal, Google Pay, and Cash App, as well as other payment facilities and marketplace.

A payment settlement entity must file Form 1099-K, Payment Card, and Third-Party Network Transactions, for payments made in settlement of reportable payment transactions for each calendar year. A reportable “payment in settlement of a reportable payment transaction” is defined by the IRS as any payment card or third-party network transaction in which the PSE submits the instruction to transfer funds to the account of the participating payee to settle the reportable payment transaction.

On December 23, 2022, the IRS issued Notice 2024-10 delaying the requirements for electronic payment networks to report transactions over \$600 to the IRS on a Form 1099-K, Payment Card, and Third-Party Network Transactions, until January 31, 2024, reporting date (for calendar year 2024 transactions).

IR-2024-33 issued on February 6, 2024, further clarified FAQs, and refers to Fact Sheet 2024-03. FS-2024-03 supersedes prior FAQs issued in FS-2023-06 in March 2023.

For tax year 2024, the IRS plan for a threshold of \$5,000 to phase in reporting requirements.

Taxpayers will report amounts from Form 1099-K on the appropriate schedule or form.

Self-employed individuals receiving Form 1099-K for credit card transactions, etc., will normally report on Schedule C, line 1 Gross Receipts.

Other business entities will normally report on their appropriate business tax form. 1120, 1120S, 1065, etc. Note that being a C corporation does not exempt the taxpayer from 1099-K reporting.

Taxpayers who receive Form 1099-K for virtual and cryptocurrency transactions will normally need to reconcile those figures on Form 8949. Caution should be used to accurately report these transactions, as the 1099-K issuer will not know (or report) the nature of the transaction, nor the basis in the asset transactions being reported.

For 1099-K forms received in error that cannot be corrected, or for sales of personal items sold at a loss, use line 8z and 24z on Schedule 1 of Form 1040 to “wash” the transaction.

1.4 Resume issuing automated reminder notices for balances due for taxable years 2022 and earlier (Notice 2024-07)

On February 9, 2022, the IRS announced in IRS News Release IR-2022-31 (IR2022-31) the temporary suspension of the mailing of certain automated reminder notices. The IRS did not suspend the mailing of initial balance due notices. The additions to tax for the failure to pay taxes owed under §§ 6651(a)(2) and 6651(a)(3) continued to accrue for taxpayers who did not fully pay their balance due.

The IRS will fully resume issuing automated reminder notices in calendar year 2024 for balances due for taxable years 2021 and earlier, thereby resuming the normal notice process for these taxable years.

The Treasury Department and the IRS issued Notice 2024-07 to provide details on relief from additions to tax for late filing and late payment. Specific tax years include 2020 and 2021 only.

Certain eligible taxpayers who have filed eligible tax returns will have the accrual of additions to tax for the failure to pay taxes owed for taxable year 2020 or 2021 waived for the relief period or, to the extent previously assessed or paid, will have such additions to tax automatically abated, refunded, or credited to other outstanding tax liabilities, as appropriate, for the relief period. There is no need for taxpayers to request this relief. The IRS will issue a notice to each eligible taxpayer that reflects the updated amount owed and any refund or credit resulting from the automatic abatement. The relief granted in this notice applies to additions to tax under §§ 6651(a)(2) and 6651(a)(3) for the failure to pay taxes owed but does not apply to any amount of interest that accrues as a result of any underpayment.

1.5 Direct File Pilot Program (Directfile.IRS.gov)

In Filing Season 2024, the IRS piloted a new option for filing an individual income tax return — Direct File — as part of the IRS’s Inflation Reduction Act Strategic Operating Plan to transform the taxpayer experience. Direct File provides taxpayers the option to electronically file their federal tax return for free, directly with the IRS.

Eligible taxpayers could use <https://directfile.irs.gov/> during the open filing period to prepare their returns directly with the IRS. In some cases, taxpayers could also file state returns.

The initial Pilot Program was limited to 1040 and 1040-SR returns. Taxpayers who only had wages, interest of \$1500 or less, unemployment compensation and Social Security and Tier 1 Railroad Retirement Benefits were eligible. In addition, only certain deductions and credits would be allowed.

Eligibility was further restricted by the requirement to be a full-year resident of one of twelve pilot states. These included eight states without state income taxes (Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming) and an additional four states (Arizona, California, Massachusetts, and New York) that agreed to partner with the IRS on the Direct File pilot.

Over the course of the pilot, more than 3.3 million taxpayers started the Direct File Eligibility Checker, 423,450 taxpayers logged in to Direct File, and 140,803 taxpayers submitted accepted returns.

The IRS is expected to continue to expand the program in future tax years.

1.6 SECURE 2.0 Act, Section 325, Roth plan distribution rules effective for 2024

The SECURE 2.0 Act is a recently enacted significant piece of legislation that has brought about substantial changes to the retirement account rules in the United States. These changes affect retirement savings plans such as 401(k), 403(b), IRA, Roth accounts, and related tax breaks.

The primary objective of SECURE 2.0 is to encourage more workers to save for retirement. However, complex changes have confused some taxpayers and plan sponsors. Therefore, it is important to understand the key points of the law.

Under the law before SECURE 2.0, you generally had to take required minimum distributions (RMDs) from your retirement plan beginning at age 72.

SECURE 2.0 increased the required minimum distribution age to 73 as of January 1, 2023. However, if you turned 72 in 2022, you had to take your first RMD by April 1, 2023.

The bump to age 73 is one of several new RMD rules. However, the RMD age eventually moves to 75.

RMD rule delay for inherited IRAs. The IRS is again delaying the implementation of IRA RMD final rules, this time until 2025.

- With previous IRS relief, penalties are waived for missed RMDs from specific IRAs inherited in 2020, 2021, 2022, and 2023.
- (Missing an RMD or failing to take the appropriate distribution amount incurs a 25% IRS penalty — down from 50% due to SECURE 2.0 RMD penalty changes — added to the amount that should have been withdrawn.) However, the penalty can be as low as 10%.
- IRS transition relief has been offered due to confusion over the timing of required plan payouts and implementation of related legislative changes.

1.7 SECURE ACT 2.0 Act, Section 603, Catch-up Contributions effective for 2024.

The Internal Revenue Service announced an administrative transition period that extends until 2026 the new requirement that any catch-up contributions made by higher-income participants in 401(k) and similar retirement plans must be designated as after-tax Roth contributions.

At the same time, the IRS also clarified that plan participants who are age 50 and over can continue to make catch-up contributions after 2023, regardless of income.

Today's announcements were included in Notice 2023-62, now posted on IRS.gov. This notice provides initial guidance for section 603 of the SECURE 2.0 Act, enacted in December 2022. Under that provision,

starting in 2024, the new Roth catch-up contribution rule applies to an employee who participates in a 401(k), 403(b) or governmental 457(b) plan and whose prior-year Social Security wages exceeded \$145,000.

The administrative transition period will help taxpayers transition smoothly to the new Roth catch-up requirement and is designed to facilitate an orderly transition for compliance with that requirement. The notice also clarifies that the SECURE 2.0 Act does not prohibit plans from permitting catch-up contributions, so plan participants who are age 50 and over can still make catch-up contributions after 2023.

The Treasury Department and the IRS plan to issue future guidance to help taxpayers, and the notice describes several positions that are expected to be included. In addition, the notice invites public comment on the matters discussed in the notice and suggestions for the future. The notice provides details on how to submit comments.

The rules do not apply to SEPS or SIMPLE Plan.

Domain 2: General Review

Domain 2 of the Annual Federal Tax Refresher (AFTR) Course reviews important concepts and guidelines for preparing individual tax returns.

Objectives

After completing Domain 2, participants should be able to:

- List types of taxable income
- Distinguish income that is not taxable
- Recall filing requirements for Schedule B
- Determine when Social Security benefits should be taxable.
- Distinguish when retirement distributions might be taxable.
- Determine when Unemployment and Alimony are taxable.
- Determine where to report and tax 1099-K amounts.
- Explain self-employment income and allowable deductions on Schedule C
- List requirements for the business use of home deduction
- Recognize forms to report capital gains and losses.
- List eligible deductions for Schedule A
- Identify taxpayer eligibility for credits.
- Recall different types of tax payments and tax withholding.
- Determine payment and refund options.
- Determine tax return due dates.

- Understand tax filing extensions.

2.1 Filing Status Review (including a reminder for Filing Status qualifying widow(er) now qualifying surviving spouse)

There are five filing statuses available. Taxpayers may qualify for more than one. They can choose the one that qualifies them to pay the lowest tax.

Single

You can choose the single box on the top of Form 1040 or 1040-SR if any of the following was true on December 31 of the tax year:

- You were never married.
- You were legally separated according to your state law under a decree of divorce or separation.
- If you were widowed before January 1 of the tax year, and didn't remarry before the end of the tax year. But if you have a child, you may be able to use the qualifying spouse filing status.

Married Filing Jointly

You can choose the married filing jointly box on the top Form 1040 or 1040-SR if any of the following apply:

- You were married on December 31 of the tax year, even if you didn't live with your spouse at the end of the tax year, or your spouse died in the following year.
- Your spouse died in the tax year, and you didn't remarry in the tax year.

Married Filing Separately

Choose the married filing box at the top Form 1040 or 1040-SR if you are married, at the end of the tax year, and file a separate return.

Head of Household

You can choose the head of the household box at the top of Form 1040 or 1040-SR if you are unmarried and provide a home for certain other persons. You are considered unmarried for this purpose if any of the following applies:

- You were legally separated according to your state law under a decree of divorce or separate maintenance at the end of the tax year. But if, at the end of the tax year, your divorce wasn't final (an interlocutory decree), you are considered married.
- You are married but lived apart from your spouse for the last six months for the tax year and you meet the other rules under Married persons who live apart. Basically, you must provide over half the support of a dependent to qualify.
- You are married and your spouse was a nonresident alien at any time during the year and the election to treat the alien spouse as a resident is not made.

Qualifying Surviving Spouse

Note: In 2022, the IRS renamed "Qualifying Widower(er)" to "Qualifying Surviving Spouse".

You can choose the qualifying surviving spouse box at the top of Form 1040 or 1040-SR and use joint return tax rates for 2024 if all the following apply:

- Your spouse died in 2022 or 2023, and you didn't remarry before the end of 2024.
 - You have a child or stepchild (**not a foster child**) whom you can claim as a dependent or could claim as a dependent except that, for 2024:
 - a. The child had gross income of \$5,050 or more,
 - b. The child filed a joint return, or
 - c. You could be claimed as a dependent on someone else's return.
- * This child lived in your home for all 2024.
 - * You paid over half the cost of keeping up your home.
 - * You could have filed a joint return with your spouse the year your spouse died, even if you didn't do so. If your spouse died in 2024, you can't file as qualifying surviving spouse. Instead, see the instructions for married filing jointly.

2.2 Taxability of Earnings (such as wages, salaries, etc.)

A tax return preparer must be able to determine all sources of taxable and nontaxable income. This includes items such as wages, salaries, interest, business income, dividends, Social Security benefits, and pension distributions.

You are generally taxed on income that is available to you, regardless of whether it is actually in your possession.

Income is either taxable or nontaxable depending on the source of income.

For tax purposes, it is important to differentiate among the various terms used to refer to income. Basic definitions of income include:

- Gross Income: All income in the form of money, property, and services is not exempt from tax.
- Earned Income: Salaries, wages, tips, professional fees, self-employment income, taxable scholarships and grants, and other amounts received as pay for work the taxpayer performs.
- Investment Income: Generally, all income other than salaries, wages, and other amounts received as pay for work actually done.

Investment income includes taxable interest, dividends, capital gains, rental and royalty income, non-qualified annuities., and certain distributions from trusts.

Examples of Taxable and Nontaxable Income

Taxable income includes (but is not limited to):

- Wages, salaries, bonuses, and commissions
- Partnership income
- IRA distributions
- Awards
- Military pay
- Interest
- Severance pays
- Hobby income
- Pensions

- Gambling winnings
- Unemployment compensation
- Dividends
- Asset Dispositions
- Tips and gratuities
- Rewards
- Alimony (finalized before 2019)
- Virtual Currency Transactions

Nontaxable income includes (but is not limited to):

- Child support
- Alimony (finalized or amended after 2018)
- Dividends on life insurance
- Federal tax refunds
- Temporary Assistance for Needy Families (TANF)
- Certain Veterans' benefits
- Welfare payments
- Rental allowance of clergy
- Worker's compensation
- Gifts and bequests.

Employee Compensation Form W-2

Pay an employee received as wages, salaries, tips, and other earnings is considered taxable income. All employed taxpayers should receive Form W-2 from their employer showing the pay received for their services.

Pay is included on line 1 of Form 1040 or 1040-SR. Even if the taxpayer doesn't receive a Form W-2, pay should be included in gross income. If services are performed (not as an independent contractor), and the employer did not withhold Social Security and Medicare taxes from the pay, the taxpayer must file Form 8919, Uncollected Social Security and Medicare Tax on Wages, with the Form 1040 or 1040-SR. These wages must be included on line 1 of Form 1040 or 1040- SR. See Form 8919 for more information.

Advance Commissions and Other Earnings

Cash-method taxpayers who receive advance commissions or other amounts for services to be performed in the future must include them in income for the year received. Accrual-method taxpayers do not have to report income in the year it was received but should report it the year earned.

If unearned commissions or other amounts are repaid in the same year received, reduce the amount included in income by the repayment. If repaid in a later tax year, the repayment can be deducted as an itemized deduction on Schedule A (Form 1040 or 1040-SR), Other Itemized Deductions, line 16, or the taxpayer may be able to take a credit for the repayment, if it is over \$3,000.

Bonuses and Awards

Bonuses or awards received for outstanding work are included in the income and should be shown on Form W-2. Bonuses and awards include prizes such as vacation trips for meeting sales goals. If the prize or award received is goods or services, include the fair market value of the goods or services in income. Bonuses or awards are not taxable until received or made available to the taxpayer.

Employee Achievement Award

Per the Tax Cuts & Jobs Act of 2017, if the taxpayer received tangible personal property (other than cash, gift certificates & cards, tickets, vacations, meals, lodging, stocks, bonds, securities, or other equivalent items) as an award for length of service or safety achievement, its value can generally be excluded from income; however, the amount excluded is limited to the employer's cost and cannot be more than \$1,600 for qualified plans (\$400 for awards that are not qualified plan awards) for all such awards received during the year.

The exclusion does not apply to the following awards:

- A length-of-service award if received for fewer than five years of service or if the taxpayer received another length-of-service award during the year or the previous four years
- A safety achievement award if the taxpayer is a manager, administrator, clerical employee, or other professional employee, or if more than 10% of eligible employees previously received safety achievement awards during the year

Severance Pay

Include in the income amounts received as severance pay and any payment for the cancellation of an employment contract.

Accrued Leave Payment

A federal employee who receives a lump-sum payment for accrued annual leave when he or she retires or resigns must have these payments included in Form W-2 as wages.

If the taxpayer resigns from one agency and is employed by another agency, the lump-sum annual leave payment may have to be partially repaid to the second agency. Reduce gross wages by the amount repaid in the same tax year the taxpayer received the payment. Attach to the tax return a copy of the receipt or statement given by the agency repaid to explain the difference between the wages on the return and the wages on Form W-2.

Sick Pay

Pay received from employers while the employee is sick or injured is part of salary or wages. Include in income sick-pay benefits received from any of the following payors:

- Welfare funds
- A state sickness or disability fund
- An association of employers or employees
- An insurance company if employer paid for the plan

NOTE: If the taxpayer paid premiums on an accident or health insurance policy, the benefits received under the policy are not taxable. This

includes some state funds paid for with taxes on employee income, paid by employees.

Military Pay

Payments received as a member of a military service generally are taxed as wages except for retirement pay, which is taxed as a pension. Allowances generally are not taxed.

Differential Wage Payments

Any payment made by an employer to an individual, who is an active-duty member of the uniformed services for more than 30 days, which represents all or a portion of the wages the individual would have received from the employer for that period, are treated as wages. The payments are subject to income tax withholding but not FICA or FUTA taxes.

Military Retirement Pay

If the retirement pay is based on age or length of service, it is taxable and must be included in income as a pension on lines 5a and 5b of Form 1040 or 1040-SR. Do not include in income the amount of any reduction in retirement or retainer pay to provide a survivor annuity for a spouse or children under the Retired Serviceman's Family Protection Plan or the Survivor Benefit Plan.

Veterans' Benefits

Do not include in income any veterans' benefits paid under any law, regulation, or administrative practice administered by the Department of Veterans Affairs (VA).

Tip Income

All tips received are income and are subject to federal income tax. Include in gross income all tips received directly, charged tips paid by the employer, and the share of any tips received under a tip-splitting or tip pooling arrangement. The value of noncash tips, such as tickets, passes, or other items of value, is also income and subject to tax.

Tip Recordkeeping

Taxpayers who receive tips should keep a daily record. If using an electronic system provided by the employer to record daily tips, taxpayers should get a paper copy of this record.

Recording tips ensures the taxpayer can accurately report tips to the employer, accurately report tips on his or her tax return, and prove the tip income, if the return is ever questioned.

The taxpayer should use the record to track the following daily:

- Cash tips from customers or from other employees
- Tips from customers who leave a tip through electronic settlement or payment. This includes credit and debit cards, gift cards, or any other electronic payment method.
- The value of any noncash tips received, such as tickets, passes, or other items of value
- Tip amounts received from other employees paid out through tip pools, tip splitting, or other arrangements

Tips Reported to Employer

Taxpayers can use Form 4070A, Employee's Daily Record of Tips to keep track of daily tip activity. Form 4070, Employee's Report of Tips to Employer, is used to report tips monthly to the employer, unless the employer provides a different method of reporting. Tip reports must be submitted to employers by the 10th of the next month (or the next weekday that is not a Saturday, Sunday, or legal holiday).

Taxpayers should follow these guidelines for reporting tips to employers:

- Report only cash, check, debit card, and credit card tips received
- For tip-splitting or tip-pooling arrangements, report only the tips received and retained
- All tips received from other employees must be reported
- Tips paid out to other employees can be deducted
- It's not necessary to report the value of any noncash tips, tickets, or passes to the employer
- If the total of tips for any one month from any one job is less than \$20, the tips do not need to be reported

Taxpayers who do not report tips are subject to a penalty equal to 50% of the Social Security and Medicare taxes or railroad retirement tax owed on the unreported tips. The penalty amount is in addition to taxes owed. If the taxpayer's regular pay is not enough for the employer to withhold all the taxes owed on the pay or the reported tips, taxpayers have until the close of the calendar year to pay the rest of the taxes.

Tips on Tax Return

Tips are reported as wages on Form 1040 or 1040-SR, line 1.

All tips received during the year must be reported on the tax return, including both cash tips and noncash tips. Tips reported to the employer by the taxpayer for the tax year are included in the wages shown in box 1 of Form W-2. Add to the amount in box 1 any tips not reported to the employer.

If the employer could not collect all the Social Security and Medicare taxes or railroad retirement tax owed on tips reported for the year, the uncollected taxes are shown in box 12 of Form W-2 (codes A and B). These amounts must be reported as other tax on the return.

To report these uncollected taxes, file a return even if the taxpayer would not have to otherwise file. Include the taxes in the total tax amount on Form 1040 or 1040-SR, Schedule 2, line 13.

Allocated Tips

Allocated tips are shown separately in box 8 of Form W-2. These tips are not included in box 1 with wages and reported tips.

All allocated tips must be reported on the tax return, including both cash and non-cash tips. Any tips the taxpayer reported to the employer are included in box 1 of the W-2. Any unreported tips, plus allocated tips from box 8, must be added to wages on Form 1040 or 1040-SR, line 1.

No income, Social Security, or Medicare taxes are withheld on allocated tips. Complete Form 4137 and include the allocated tips on line 1 of the form.

Example:

Valentina began working at the First Star Restaurant on June 30 and received \$10,000 in wages during the year. Valentina kept a daily tip record showing that his tips for June were \$18 and his tips for the rest of the year totaled \$7,000. He was not required to report his June tips to his employer, but he reported all the rest of his tips to his employer as required.

Valentina's Form W-2 from First Star Restaurant shows \$17,000 (\$10,000 wages plus \$7,000 reported tips) in box 1. Add the \$18 of unreported tips to that amount and report \$17,018 as wages on his tax return.

2.3 Schedule B: Interest, Dividends, Foreign Accounts and Trusts

In general, interest received or credited to an account is taxable; however, there are some exceptions. In addition to keeping any forms showing the amount of interest income received, taxpayers should keep a record of all sources of interest and amounts received during the year.

Interest income is generally not subject to regular withholding; however, it may be subject to backup withholding to ensure that income tax is collected on the income. Under backup withholding, the payor of interest must withhold, as income tax, 28% of the amount paid.

Reporting Interest

Interest income is generally reported on Form 1099-INT or a similar statement by banks, savings and loans, and other payers of interest. This form shows the amount of interest received during the year. If backup withholding is deducted from interest, Form 1099-INT shows the amount withheld as "Federal income tax withheld."

All taxable interest income must be reported, even if the taxpayer didn't receive Form 1099-INT.

Reportable interest income also may be shown on Form 1099-OID, Original Issue Discount.

If a taxpayer received any federally tax-exempt interest such as from municipal bonds, it should be reported on line 2a on Form 1040 or 1040-SR.

General Rules for Interest

Individual Retirement Arrangements (IRAs)

Interest in a Roth IRA generally is not taxable. Interest on a traditional IRA is tax-deferred and generally not included in income until withdrawals are made from the IRA.

Beneficiary of an Estate or Trust

Interest received as a beneficiary of an estate or trust is generally taxable income. The taxpayer should receive Schedule K-1 (Form 1041), Beneficiary's Share of Income, Deductions, Credits, etc., from the fiduciary.

Exempt Interest Dividends

Exempt-interest dividends received from mutual funds or other regulated investment companies are not included in taxable income. Basis is not reduced for distributions that are exempt-interest dividends. Exempt interest dividends are shown in box 12 of Form 1099-DIV.

Although exempt-interest dividends are not taxable, these dividends must be reported if the taxpayer is required to file a tax return. This is an

information-reporting requirement and does not change the exempt interest dividends into taxable income. Report exempt-interest dividends on Form 1040, line 2a.

Interest on VA Dividends

Interest on insurance dividends left on deposit with the VA is not taxable. This includes interest paid on dividends on converted United States Government Life Insurance and on National Service Life Insurance policies.

Taxable Interest

Taxable interest includes interest received from bank accounts, loans made to others, and other sources.

Dividends That Are Actually Interest

Certain distributions commonly called dividends are actually interest. Report as interest so-called “dividends” on deposits or on share accounts in:

- Cooperative banks
- Credit unions
- Domestic building and loan associations
- Domestic savings and loan associations
- Federal savings and loan associations
- Mutual savings banks

Money Market Funds

Money market funds pay dividends and are offered by nonbank financial institutions, such as mutual funds and stock brokerage houses. Generally, amounts received from money market funds should be reported as dividends, not as interest.

Gift for Opening an Account

Report as interest the value of non-cash gifts or services received for making deposits or for opening an account in a savings institution.

For deposits of less than \$5,000, gifts or services valued at more than \$10 must be reported as interest. For deposits of \$5,000 or more, gifts or services valued at more than \$20 must be reported as interest. The value is determined by the cost to the financial institution.

Example:

Jessica and her husband Nick each open a savings account. Jessica deposits \$3,500.00 and receives a cup valued at \$15.00. Nick deposits \$5,800 and receives another pen and leather-bound notebook valued at \$40.00. Both Jessica and Nick must report the value of the gifts received.

Certificates of Deposit (Deferred Interest Accounts)

Interest is usually paid at fixed intervals of one year or less during the term of the account. Include this interest in income when it's received or when the interest is entitled to be received without receiving a substantial penalty. The same is true for accounts that mature in one year or less and pay interest on a single payment at maturity.

If interest is deferred for more than one year, see "Original Issue Discount (OID)," later in this course.

- If penalized for early withdrawal, report the total amount of interest paid or credited to the account during the year, without subtracting the penalty.
- If money is borrowed to invest in a certificate of deposit, still report the total interest earned on the certificate in income. Taxpayers who itemize can deduct the interest paid as investment interest, up to the amount of the net investment income.

Interest on Tax Refunds

Interest received on tax refunds is taxable income.

Interest on Condemnation Award

If the condemning authority pays interest to compensate for a delay in payment of an award, the interest is taxable.

Installment Sale Payments

If a contract for the sale or exchange of property provides for deferred payments, it also usually provides for interest payable with the deferred payments. That interest is taxable when it's received. If the installment sales contract doesn't provide for adequate stated interest, part of the stated principal may be recharacterized as unstated interest or original issue discount for tax purposes, even if you have a loss. You must use the applicable federal rate (AFR) to figure the amount of stated principal recharacterized as unstated interest or original issue discount.

The AFRs are published monthly in the Index of Applicable Federal Rates (AFR) Rulings.

Interest on Annuity Contracts

Accumulated interest on annuity contracts sold before maturity is taxable.

Usurious Interest

Usurious interest is interest charged at an illegal rate. This is taxable as interest unless state law automatically changes it to a payment on the principal.

U.S. Savings Bonds

If the taxpayer is using the accrual method of accounting, interest from U.S. savings bonds must be reported each year as it accrues. Taxpayers cannot postpone reporting interest until it's received or until the bonds mature. If using the cash method of accounting (as most individual taxpayers do), U.S. savings bond interest is generally reported when it's received.

Series H and HH Bonds

Series HH Bonds were issued at face value. Interest is paid twice a year by direct deposit to the taxpayer's bank account. If using the cash method, report interest on these bonds as income on the taxpayer's return the year it was received.

Series I Bonds

Series I bond were first offered in 1998. These inflation-indexed bonds are issued at their face amount with a maturity period of 30 years. The face value plus all accrued interest is payable at maturity. The interest rate is a combination of a fixed rate plus a variable inflation rate (adjusted semi-annually in May and November).

Series EE and Series I Bonds

Interest in series EE and series I bonds is payable when the bonds are redeemed. The difference between the purchase price and the redemption value is taxable interest.

Series EE bonds

Series EE bonds were first offered in January 1980 and have a maturity period of 30 years.

- Before July 1980, series E bonds were issued. The original 10-year maturity period of series E bonds has been extended to 40 years for bonds issued before December 1965 and 30 years for bonds issued after November 1965.
- Paper series EE and series E bonds are issued at a discount. The face value is payable at maturity.
- Electronic series EE bonds are issued at their face value. The face value plus accrued interest is payable at maturity.

Owners of paper series EE bonds can convert them to electronic bonds. These converted bonds do not retain the denomination listed on the paper certificate but are posted at their purchase price (with accrued interest).

Taxpayers using the cash method of reporting income should report the interest on series EE, series E, and series I bonds using one of the following two methods:

Method 1 - Postpone reporting the interest until the year the bond is cashed or disposed of or the year of maturity, whichever is earlier.

NOTE: Series EE bonds issued in 1983 matured in 2013. If method 1 has been used, the taxpayer generally must report the interest on these bonds

on the 2013 return. The last series E bonds were issued in 1980 and matured in 2010. If using method 1, generally the interest should have been reported on the 2010 return.

Method 2 - Choose to report the increase in redemption value as interest each year.

Choose the same reporting method for all series EE, series E, and series I bonds being reported for the taxpayer. If method 2 is not chosen, method 1 must be used.

Example:

Laine owns a \$500.00 U.S. Series EE Savings Bond. She paid \$250.00 for the bond. When the bond matures, Laine will receive \$500.00. At the end of the first year, the bond is worth \$265.00.

Laine can report interest income in one of two ways. She can:

a) Report \$250.00 of interest income only once the bond matures.

This is the difference between the \$500.00 value at maturity and the \$250.00 she paid for the bond.

b) Report \$15.00 of interest income at the end of the first year.

This is the increase in value at the end of year (\$265.00 minus \$250.00); Laine would report interest income each year until maturity.

Changing Reporting Options (Series EE and Series I)

Change from Method 1

If changing the method of reporting the interest from method 1 to method 2, it is not necessary to get permission from the IRS. In the year of change,

report all interest accrued to date and not previously reported for all the bonds.

Once the method has changed to where the interest is reported each year, all series EE, series E, and series I bonds must be reported this way on all future returns, unless permission is granted to change (explained next).

Change from Method 2

To change from Method 2 to Method 1, the IRS must grant permission. Permission is requested by either filing Form 3115, Application for Change in Accounting Method, or by submitting a statement to the IRS.

Submitted statements must include the following criteria:

- “131” typed or printed at the top of the page
- Taxpayer’s name and SSN located under the “131”
- The year of change (both the beginning and ending dates)
- The identification of savings bonds for which the change is being requested

The taxpayer must also agree to (a) report all interest on any bonds acquired during or after the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earliest, and (b) report all interest on the bonds acquired before the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earliest, with the exception of the interest reported in prior tax years.

The statement must be attached to the tax return for the year of change, and the return must be filed by the due date (including extensions). If necessary, an amended return can be filed.

Bonds with Co-Owners

If a U.S. savings bond is issued in the names of co-owners, such as the taxpayer and a child, or the taxpayer and spouse, interest on the bond is generally taxable to the co-owner who bought the bond.

If funds of one taxpayer are used to purchase the bond, taxes must be paid on the interest. This is true even if the taxpayer let the other co-owner redeem the bond and keep all the proceeds. Under these circumstances, the co-owner who redeemed the bond will receive a Form 1099-INT at the time of redemption and must provide the other co-owner with another Form 1099-INT showing the amount of interest from the bond taxable to them.

If each co-owner contributes part of the bond's purchase price, the interest is generally taxable to each co-owner, in proportion to the amount each paid.

If the taxpayer and spouse live in a community property state and hold bonds as community property, one-half of the interest is considered received by each of them. When filing separate returns, each taxpayer generally must report one-half of the bond interest.

If the taxpayer bought series E, series EE, or series I bonds entirely with his or her own funds and had them reissued in a co-owner's name or beneficiary's name alone, include in gross income for the year of reissue all interest earned on these bonds not previously reported; but, if the bonds were reissued in the taxpayer's name alone, the interest accrued does not

have to be reported at that time. This same rule applies when bonds (other than bonds held as community property) are transferred between spouses or incident to divorce.

If the co-owners contributed funds to buy series E, series EE, or series I bonds jointly and later had the bonds reissued in one co-owner's name alone, taxpayers must include in gross income for the year of reissue the share earned on the bonds not previously reported.

The former co-owner does not have to include in gross income at the time of reissue his or her share of the interest earned that was not reported before the transfer. This interest, however, as well as all interest earned after the reissue, is income to the former co-owner.

This income-reporting rule also applies when the bonds are reissued in the name of a former co-owner and a new co-owner. In this scenario, the new co-owner reports his or her share of the interest earned after the transfer. If bonds that a taxpayer and a co-owner bought jointly are reissued to each separately in the same proportion as his or her contribution to the purchase price, neither co-owner has to report at that time the interest earned before the bonds were reissued.

Bonds Transferred to a Trust

Taxpayers who own series E, series EE, or series I bonds and transfer them to a trust, giving up all rights of ownership, must include in income for that year the interest earned to the date of transfer if it's not already been reported. If, however, the taxpayer is considered the owner of the trust and if the increase in value both before and after the transfer continues to be taxable to him or her, the reporting of interest earned each year can be deferred. In this case, include the total interest in income in the year the

taxpayer cashes or disposes of the bonds or the year the bonds finally mature, whichever is early.

Example:

Tina and Betty spent an equal amount to buy a \$1,000.00 series EE savings bond as co-owners. They both postpone reporting interest on the bond. Later, they have the bond reissued as two \$500.00 bonds, one in each of their names. At that time, neither Tina nor Betty has to report the interest earned to the date of reissue.

Form 1099-INT for U.S. Savings Bonds Interest

When a bond is cashed, the bank or other payor that redeems it must give the taxpayer Form 1099-INT if the interest part of the payment received is \$10 or more. Box 3 of Form 1099-INT should show the interest as the difference between the amounts received and the amount paid for the bond; however, Form 1099-INT might show more interest than what has to be included on the income tax return.

Examples of when can be more interest on the 1099-INT than what must be reported include:

- a) The taxpayer chose to report the increase in the redemption value of the bond each year. The interest shown on form 1099-INT will not be reduced by amounts previously include in income.
- b) The taxpayer received the bond from a decedent. The interest show on the Form 1099-INT will not be reduced by any interest reported by the decedent before death, or on the decedent's final return, or by the estate on the estate's income tax return.

- c) Ownership of the bond was transferred. The interest shown on Form 1099-INT will not be reduced by interest that accrued before the transfer.
- d) The taxpayer was named as a co-owner, and the other co-owner contributed funds to by the bond. The interest shown on Form 1099-INT will not be reduced by the interest portion of the amount received as nominee for the other co-owner.

If a taxpayer received the bond in a taxable distribution from a retirement or profit-sharing plan, the interest shown on Form 1099-INT will not be reduced by the interest portion of the amount taxable as a distribution from the plan and not taxable as interest.

Education Savings Bond Program

All or part of the interest received on the redemption of qualified U.S. savings bonds during the year can be excluded if the taxpayer paid qualified higher educational expenses during the same year. This exclusion is known as the Education Savings Bond Program. Married Filing Separately taxpayers do not qualify for this exclusion.

Form 8815, Exclusion of Interest from Series EE, and I US Savings Bonds Issued After 1989 is used to figure the exclusion and must be attached to Form 1040 or 1040-SR.

Taxpayers can take the exclusion if all four of the following apply.

1. Taxpayer cashed qualified U.S. savings bond in current tax year that were issued after 1989.
2. Taxpayers paid qualified higher education expenses in the current year for self, spouse, or dependents.

3. The filing status on the current year return is any status other than married filing separately.

4. The taxpayer's modified adjusted gross income (MAGI) in 2024 is less than \$111,800 if single or head of household, or qualifying widow; \$175,200 if married filing jointly.

Modified AGI, for purposes of this exclusion, is adjusted gross income figured before the interest exclusion, and modified by adding back any:

- Foreign earned income exclusion
- Foreign housing exclusion and deduction
- Exclusion of income for bona fide residents of American Samoa
- Exclusion for income from Puerto Rico
- Exclusion for adoption benefits received under an employer's adoption assistance program
- Deduction for tuition and fees
- Deduction for student loan interest
- Deduction for domestic production activities

What makes the bond qualified?

The U.S. savings bond is a series EE bond issued after 1989 or a series I bond

- The bond is issued either in the taxpayer's name (sole owner) or in the taxpayer and spouse's names (co-owners)

- The taxpayer is at least 24 years old before the bond's issue date. Any individual (including a child) can be the beneficiary of the bond. **Qualified Higher Education Expenses**

Qualified higher education expenses are tuition and fees required for the taxpayer, the spouse, or their dependent (if claimed as an exemption) to attend an eligible educational institution.

Qualified expenses include any contribution made to a qualified tuition program or to a Coverdell education savings account.

Qualified expenses do not include expenses for room and board or for courses involving sports, games, or hobbies that are not part of a degree or certificate granting program.

Eligible Educational Institutions

Eligible educational institutions include most public, private, and nonprofit universities, colleges, and vocational schools that are accredited and eligible to participate in student aid programs run by the U.S. Department of Education.

Reduction for Certain Benefits

Qualified higher educational expenses must be reduced by all the following tax-free benefits:

- Tax-free part of scholarships and fellowships
- Expenses used to figure the tax-free portion of distributions from a Coverdell ESA
- Expenses used to figure the tax-free portion of distributions from a qualified tuition program

- Any tax-free payments (other than gifts or inheritances) received for educational expenses, such as veterans' educational assistance benefits, qualified tuition reductions, or employer-provided educational assistance
- Any expense used in figuring the American Opportunity and Lifetime Learning credits

If the total proceeds (interest and principal) from the qualified U.S. savings bonds redeemed during the year are not more than the adjusted qualified higher educational expenses for the year, the taxpayer might be able to exclude all the interest.

If the proceeds are more than the expenses, the taxpayer might be able to exclude only part of the interest.

Use Form 8815 to determine the maximum excludable amount, including MAGI limitations. Divide the qualified higher education expenses by the proceeds received during the year then multiply that amount by the interest.

Example:

Cindy and Bonnie cashed a qualified series EE U.S. savings bond and received \$8,000, \$5,000 which was principal and \$3,000 was interest. During the tax year, they paid \$4,000 of their son's college tuition. They are not claiming an education credit for that amount, their MAGI is within limits, and their son does not have any tax-free educational assistance. They can exclude \$1,500 interest and must pay tax on the remaining \$1,500 interest.

Interest x (Qualified expenses ÷ Proceeds received during the year)

= amount to exclude from income

$\$3,000 \times (\$4,000 \div \$8,000) = \$1,500$

$\$3,000 - \$1,500$ (amount of interest to exclude) = $\$1,500$

Reporting Interest Income on Non-Savings Bonds

The reporting of interest income depends on the taxpayer and the method used to report income. Most individuals use the cash method of income reporting; however, some do use the accrual method.

Cash Method

In general, interest income is reported in the year it is actually or constructively received.

Income is constructively received when it is credited to the taxpayer's account or made available to them.

Accrual Method

Interest income is reported when it is earned, not when it is received. Interest is earned over the term of the debt instrument.

Example:

In August of 2023, Joe loaned Terry \$3,500 at 10%, compounded annually. The note stated that principal and interest would be due on August 31, 2024. Joe received \$4,222.20 (\$3,500 principal and \$722.20 of interest). If using the cash method, include in income on the 2024 return the \$722.20 interest Joe received that year.

If Joe is using the accrual method, include the interest as it is earned.

For example, in 2022 - \$350; 2023 - \$244.26; and 2024 - \$127.94.

Generally, report all taxable interest income on Form 1040 or 1040-SR, line 2b.

Schedule B

If Schedule B, Interest and Ordinary Dividends, is required, list each payer's name and the amount of interest income received from each payer on line 1. If Form 1099-INT or Form 1099- OID is received from a brokerage firm, list the brokerage firm as the payer.

When reporting interest income, complete Schedule B if filing Form 1040 or 1040-SR and any of the following are true:

- Taxable interest income or ordinary dividends is more than \$1,500
- Taxpayer is claiming the interest exclusion under the Education Savings Bond Program from series EE, or I U.S. savings bonds issued after 1989
- Taxpayer received interest from a seller-financed mortgage, and the buyer used the property as a home
- Taxpayer received accrued interest from a bond
- The taxpayer received, as a nominee, interest or ordinary dividends that actually belongs to someone else.
- Taxpayer is reporting interest income of less than the amount shown on a Form 1099 due to amortizable bond premium
- Taxpayer is reporting OID in an amount less than the amount shown on Form 1099-OID

- Taxpayer had a financial interest in, or signature authority over, a financial account in a foreign country or received a distribution from, or were a grantor of, or transferor to, a foreign trust

Reporting Tax-Exempt Interest

Total all tax-exempt interest and exempt-interest dividends from all sources as shown in box 8 of Form 1099-INT. For tax-exempt OID on tax-exempt bonds, use box 2 of Form 1099-OID and box 11 of Form 1099-OID. Also include any exempt-interest dividends from a mutual fund or other regulated investment company, as reported in box 11 of Form 1099-DIV. Amounts from box 13, Form 1099-INT are bond premiums on tax-exempt bonds. Bond premiums generally reduce the amount reported on line 2a. Report the net total on line 2a of Form 1040 or 1040-SR.

Box 9 on Form 1099-INT shows the tax-exempt interest subject to the alternative minimum tax on Form 6251, Alternative Minimum Tax—Individuals. It is already included in the amount in box 8. Do not add the amount in box 9 to, or subtract from, the amount in box 8.

Dividend Income

Dividends are distributions of money, stock, or other property paid to a person by a corporation or by a mutual fund. Distributions can consist of cash, more stock, stock rights, other property, or services.

Dividends can be classified as ordinary or qualified. Ordinary dividends are taxable as ordinary income. Qualified dividends meeting certain requirements are taxed at lower capital gains rates.

Most corporations and mutual funds distribute Form 1099-DIV, Dividends and Distributions, to show the distributions made during the year and any tax withheld from the dividend income.

If another person receives distributions as a nominee for the taxpayer, that person will provide a Form 1099-DIV to the taxpayer, which will show distributions received on his or her behalf.

General Rules for Dividend Income Backup Withholding

Dividend income is generally not subject to regular withholding but could be subject to backup withholding to ensure that income tax is collected on the income. Under backup withholding, the payer of dividends must withhold as income tax 24% of the amount paid.

Beneficiaries of an Estate or Trust

Dividends and other distributions received as a beneficiary of an estate or trust are generally taxable income. The taxpayer should receive Schedule K-1 (Form 1041), Beneficiary's Share of Income, Deductions, Credits, etc., from the fiduciary. Schedule K-1 and its instructions discuss how and where to report this income.

Stock Certificate in Two or More Names

If two or more people hold stock as joint tenants, tenants by the entirety, or tenants in common, each person's share of any dividends from the stock is determined by local law.

Dividends on Stock Sold

If stock is sold, exchanged, or otherwise disposed of after a dividend is declared but before it is paid, the owner of the record (usually the payee shown on the dividend check) must include the dividend in income.

Dividends Received in January

If a mutual fund (or other regulated investment company) or real estate investment trust (REIT) declares a dividend (including any exempt interest dividend or capital gain distribution) in October, November, or December that is payable to shareholders of record on a date in one of those months but actually pays the dividend during January of the next calendar year, the dividend is considered received on December 31. Report the dividend in the year it was declared.

Ordinary Dividends

Ordinary dividends are the most common type of distribution from a corporation or a mutual fund. These distributions are paid out of earnings and profits and are ordinary income to the taxpayer and are not capital gains. Ordinary dividends are shown in box 1a of Form 1099-DIV.

Qualified Dividends

Qualified dividends are the ordinary dividends subject to the same 0%, 15%, or 20% maximum tax rate that applies to net capital gains. Qualified dividends should be shown in box 1b of Form 1099-DIV. The tax rate depends on adjusted gross income.

To qualify for the 0%, 15%, or 20% maximum rate, all the following requirements must be met.

- The dividends must have been paid by a U.S. corporation or a qualified foreign corporation
- The dividends are not of the type listed later under Dividends that are not Qualified Dividends
- The holding period is met

The taxpayer must have held the stock for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date. The exempt dividend date is the first date following the declaration of a dividend on which the buyer of a stock is not entitled to receive the next dividend payment. Instead, the seller will get the dividend.

When counting the number of days, the taxpayer held the stock, including the day the stock was disposed of, but not the day it was acquired.

In the case of preferred stock, the taxpayer must have held the stock for more than 90 days during the 181-day period that begins 90 days before the ex-dividend date if the dividends are due to periods totaling more than 366 days. If the preferred dividends are due to periods totaling less than 367 days, the holding period in the previous paragraph applies.

When determining whether the taxpayer met the holding periods, do not count any day during which any of the following conditions are met:

- The taxpayer had the option to sell, was under a contractual obligation to sell, or had made (and not closed) a short sale of substantially identical stock or securities
- The taxpayer was a grantor (writer) of an option to buy substantially identical stock or securities
- The taxpayer's risk of loss is diminished by holding one or more other positions in substantially similar or related property

Dividends that are Not Qualified Dividends

The following dividends are not qualified dividends, even if shown in box 1b of Form 1099-DIV:

- Capital gain distributions

- Dividends paid on deposits with mutual savings banks, cooperative banks, credit unions,

U.S. building and loan associations, U.S. savings and loan associations, federal savings and loan associations, and similar financial institutions (Report these amounts as interest income)

- Dividends from a corporation that is a tax-exempt organization or farmer's cooperative during the corporation's tax year in which the dividends were paid or during the corporation's previous tax year.
- Dividends paid by a corporation on employer securities held on the date of record by an employee stock ownership plan (ESOP) maintained by that corporation.
- Dividends on any share of stock to the extent the person is obligated (whether under a short sale or otherwise) to make related payments for positions in substantially similar or related property.
- Payments in lieu of dividends, but only if it's known or if there is reason to know the payments are not qualified dividends.
- Payments shown in Form 1099-DIV, box 1b, from a foreign corporation to the extent of knowing or having reason to know that the payments are not qualified dividends.

Capital Gain Distributions

Capital gain distributions (also called capital gain dividends) are paid to or credited to an account by mutual funds (or other regulated investment companies) and real estate investment trusts (REITs). These distributions are shown in box 2a of Form 1099-DIV.

Report capital gain distributions as long-term capital gains.

Other Distributions

Taxpayers could receive any of the following distributions during the year.

Exempt-Interest Dividends

Exempt-interest dividends received from mutual funds or other regulated investment companies are not included in taxable income. Exempt interest dividends should be shown in box 12 of Form 1099-DIV. While not taxable, these dividends must be reported on the return.

Exempt-interest dividends paid from specified private activity bonds may be subject to the alternative minimum tax. These are reported in box 13 of Form 1099-DIV.

Dividends on Insurance Policies

Insurance policy dividends the insurer keeps and uses to pay the taxpayer's premiums are not taxable; however, the interest that is paid or credited on dividends left with the insurance company must be reported as taxable interest income. Dividends on an insurance contract (other than a modified endowment contract) distributed to the taxpayer are a partial return of the premiums paid. Do not include in gross income until distributions are more than the total of all net premiums paid for the contract.

Report any taxable distributions from insurance policies on Schedule 1, line 8z.

Dividends on Veterans' Insurance

Neither dividends received on veterans' insurance policies nor interest on dividends left with the Department of Veterans Affairs is taxable.

Patronage Dividends

Generally, patronage dividends received from a cooperative organization are included in income. Do not include in income patronage dividends received on property bought for personal use, or capital assets or depreciable property bought for business use. The basis (cost) of the items bought, however, must be reduced. If the dividend is more than the adjusted basis of the assets, report the excess as income.

Alaska Permanent Fund Dividends

Do not report these amounts as dividends. Instead, report these amounts on Schedule 1, line 8f.

Reporting Dividend Income

Both Ordinary and Qualified Dividends are normally reported on Form 1099-DIV. Qualified dividends are ordinary dividends that are qualified to be taxed under capital gains rates. The qualified dividend amount will never be greater than the ordinary dividend amount reported on the same 1099-DIV.

Report the total qualified dividends on line 3a of Form 1040 or 1040-SR. Ordinary dividends are reported on line 3b.

A taxpayer who owns stock on which he or she received \$10 or more in dividends and other distributions, should receive Form 1099-DIV. Regardless of whether a 1099-DIV is received, the taxable dividend income must be reported.

Complete Schedule B, Part II, and attach it to Form 1040 or 1040-SR, if either of the following is true:

- Ordinary dividends (Form 1099-DIV, box 1a) total more than \$1,500
- The taxpayer received, as a nominee, dividends that belonged to someone else Do not include any of the following on line 3a:
- Qualified dividends received as a nominee
- Dividends on stock for which the holding period was not met
- Dividends on any share of stock to the extent the taxpayer is obligated (whether under a short sale or otherwise) to make related payments for positions in substantially similar or related property
- Payments in lieu of dividends, but only if known or there is reason to know that the payments are not qualified dividends
- Payments shown in Form 1099-DIV, box 1b, from a foreign corporation to the extent it is known or there is reason to know, that the payments are not qualified dividends

Other Income

Taxable State and Local Refunds

Taxpayers must report all items of income received in the form of money, property, and services, unless tax law states otherwise. Some income received is taxable, some income may be partly taxed, and some income can be excluded from being taxed.

Taxable Refunds, Credits, or Offsets of State and Local Taxes

If a taxpayer received a state or local income tax refund (or credit or offset) in the tax year, it must generally be included in income if it was deducted as an itemized deduction in an earlier tax year. The taxpayer should receive Form 1099-G, Certain Government Payments, reporting amounts from the payer.

None of the state tax refunds are taxable if the taxpayer did not itemize in the prior tax year or elected to deduct state and local general sales taxes instead of income taxes.

Use the State and Local Income Tax Refund Worksheet (found in Form 1040 or 1040-SR instructions) to determine if the state or local refund is taxable. Taxable amounts should be reported on Schedule 1, line 1.

If choosing to deduct for a tax year either state and local income taxes or state and local general sales taxes, then the maximum amount to include in income is limited to the excess of the tax chosen to be deducted for that year over the tax not chosen to be deducted for that year. In general, if sales tax was deducted in the prior year, instead of state and local income tax, the 1099-G payments will not be taxable.

Bartering

Bartering is an exchange of property or services. The fair market value of property or services received in bartering is included in income. If the parties involved agree upon the value of the services, that value is accepted as fair market value unless the value can be shown to be otherwise.

Generally, this income is reported on Schedule C, Profit or Loss from Business; however, if the barter involves an exchange of something other than services, another form or schedule may have to be used.

If you exchanged property or services through a barter exchange, you should expect to receive a Form 1099-B (or a similar statement). Box 13 will show the value of cash, property, services, credits, or script you received from bartering.

Canceled Debt

Generally, if a debt owed is canceled or forgiven, other than as a gift or bequest, the cancelled amount must be included in income.

If the debt is a nonbusiness debt, report the canceled amount on Schedule 1, line 8c.

If it is a business debt, report the amount on Schedule C if non-farm. Use Schedule F, Profit or Loss from Farming, if the debt is farm debt and the taxpayer is a farmer.

Personal vehicle repossession. If you had a personal vehicle repossessed and disposed of by the lender during the year, you will need to determine your gain or nondeductible loss on the disposition.

If the lender also canceled all or part of the remaining amount of the loan, you may be able to exclude the canceled debt from income if the cancellation occurred in a title 11 bankruptcy case or you were insolvent immediately before the cancellation. You should read Bankruptcy or Insolvency under Exclusions in chapter 1 to see if you can exclude the canceled debt from income under one of those provisions.

Nonbusiness credit card debt cancellation. If you had a nonbusiness credit card debt canceled, you may be able to exclude the canceled debt

from income if the cancellation occurred in a title 11 bankruptcy case or you were insolvent immediately before the cancellation. You should read Bankruptcy or Insolvency under Exclusions in chapter 1 to see if you can exclude the canceled debt from income under one of those provisions.

Form 1099-C

If a federal government agency, financial institution, or credit union cancels or forgives a debt of \$600 or more, the taxpayer will receive Form 1099-C, Cancellation of Debt. The amount of the canceled debt is shown in box 2.

If any interest is forgiven and included in the amount of canceled debt in box 2, the amount of interest is also shown in box 3. Whether or not to include the interest portion of the canceled debt in income depends on whether the interest would be deductible if the taxpayer paid it.

If the interest would not be deductible (such as interest on a personal loan), include in the income the amount from Form 1099-C, box 2.

If the interest would be deductible (such as on a business loan), include in income the net amount of the canceled debt (the amount shown in box 2 less the interest amount shown in box 3).

Repayment of Canceled Debt

If the canceled amount is included in income, and later the taxpayer pays the debt, a claim for refund can be filed for the year the amount was included in income.

Other cancelled debts can include the following:

- Discounted mortgage loans
- Mortgage relief upon sale or other disposition

- Stockholder debt

Discounted Mortgage Loans

If a financial institution offers a discount for the early payment of a mortgage loan, the amount of the discount is canceled debt, and the canceled amount must be included in income.

Mortgage Relief Upon Sale or Other Disposition

If a taxpayer is personally liable for a mortgage (recourse debt), and is relieved of the mortgage, a gain or loss may be realized on the fair market value of the property. To the extent the mortgage discharge exceeds the fair market value of the property, it is income from discharge of indebtedness unless it qualifies for exclusion, discussed later. The income is reported on Schedule 1, line 8c. For taxpayers not personally liable for a mortgage (nonrecourse debt) relieved of mortgage debt (such as through foreclosure), that relief is included in the amount realized. There could be a taxable gain if the amount realized exceeds the adjusted basis in the property. Report any gain on nonbusiness property as a capital gain.

Stockholder Debt

If a corporation cancels or forgives a stockholder's debt, the canceled debt is a constructive distribution that is generally dividend income to the stockholder. If the stockholders cancel a debt owed by the corporation, the stockholder (taxpayer) does not recognize the income. The canceled debt is considered a contribution to the capital of the corporation equal to the amount of debt principal canceled.

Exceptions

There are several exceptions to the inclusion of canceled debt in income. Exceptions are considered before applying exclusions.

Student loans – Public Service Certain student loans contain a provision that all or part of the debt incurred to attend the qualified educational institution will be canceled if the student works for a certain period in certain public service professions for any of a broad class of employers. The canceled amount is not included in income if this provision is part of a loan made by a qualifying institution.

Student Loans. Death or Disability of the Student – For tax years 2018 through 2025, student loan debts cancelled by the death or disability of the student are excluded from gross income.

Deductible debt. The cancellation of a debt is not considered income if the payment of the debt would be deductible (for taxpayers using the cash method of accounting only).

Price reduced after purchase. If the seller reduces the amount of debt owed for property purchased, the reduced amount is not included in income. The reduction is treated as a purchase price adjustment and reduces the basis in the property.

Gifts & Bequests. The cancellation of a debt is not considered income if the lender is treating the cancellation as a gift.

Excluded Debt

For cancelled debt excluded from income under the following provisions, the associated tax attributes (basis, losses, credits, etc.) must be reduced.

Report these on Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness.

Do not include a canceled debt in gross income in any of the following situations:

- The debt is canceled in a bankruptcy case under title 11 of the U.S. Code.
- The debt is canceled when the taxpayer is insolvent immediately prior to cancellation (exclude only up to the amount by which the taxpayer is insolvent).
- The debt is qualified farm debt and is canceled by a qualified person.
- The debt is qualified real property business debt.
- The debt is qualified principal residence indebtedness.

Life Insurance Proceeds

Life insurance proceeds paid upon the death of an insured are not taxable unless the policy was turned over for a price. If the policy was transferred to you for cash or other valuable consideration, the exclusion for the proceeds is limited to the sum of the consideration you paid, additional premiums you paid, and certain other amounts. This is true even if the proceeds were paid under an accident or health insurance policy or an endowment contract.

However, interest income received as a result of life insurance proceeds may be taxable.

- Lump-sum payment - If death benefits are paid in a lump sum or other than at regular intervals, include in income only the number of benefits that are more than the amount payable at the time of the

insured person's death. If the benefit payable at death is not specified, include in income the benefit payments that are more than the present value of the payments at the time of death.

- Installment payments – If life insurance proceeds are received in installments, exclude part of each installment from income. To determine the excluded part, divide the amount held by the insurance company by the number of installments to be paid. Include anything over this excluded part in income as interest.

NOTE: If insurance proceeds are paid because of the death of a spouse before October 23, 1986, and those payments are received in installments, exclude up to \$1,000 a year of the interest included in the installments, even if the taxpayer remarries.

Surrender of Policy for Cash

If a life insurance policy is surrendered for cash, include in income any proceeds that are more than the cost of the life insurance policy. Taxpayers should receive Form 1099-R showing the total proceeds and the taxable part. Report these amounts on lines 5a and 5b of Form 1040 or 1040-SR.

Accelerated Death Benefits

Certain amounts paid as accelerated death benefits under a life insurance contract or viatical settlement before the insured's death are excluded from income if the insured is terminally or chronically ill.

- Accelerated death benefits are fully excludable if the insured is a terminally ill individual.

- If the insured is a chronically ill individual who is not terminally ill, accelerated death benefits paid on the basis of costs incurred for qualified long-term care services are fully excludable.

The exclusion does not apply to any amount paid to a person (other than the insured) who has an insurable interest in the life of the insured because the insured is a director, officer, or employee of the person, or has as a financial interest in the person's business.

Public Safety Officer Killed in the Line of Duty

The survivor of a public safety officer killed in the line of duty may be able to exclude from income certain amounts received.

For more information, see Publication 559, Survivors, Executors, and Administrators.

Recoveries

A recovery is a return of an amount either taken as a deduction or a credit in an earlier year. The most common recoveries are refunds, reimbursements, and rebates of deductions itemized on Schedule A. A taxpayer can also have a recovery on previously deducted bad debts or a previously claimed tax credit.

Include a recovery in income the year it's received up to the amount by which the deduction or credit taken for the recovered amount reduced the taxpayer's tax in the earlier year. Any increase to an amount carried over to the current year that resulted from the deduction or credit is considered to have reduced tax in the earlier year.

Mortgage Interest Refund

If the taxpayer received a refund or credit of mortgage interest paid in an earlier year, the amount is shown in box 4 of Form 1098, Mortgage Interest Statement. Do not subtract the refund amount from the interest paid in the current tax year. Certain rules may require it to be included in the income.

- Interest on recovery - Interest on any of the amounts recovered must be reported as interest income in the year received. For example, report any interest received on state or local income tax refunds on Form 1040 or 1040-SR, line 2b.
- Recovery and expense in same year - If the refund or other recovery and the expense occur in the same year, the recovery reduces the deduction or credit and is not reported as income.
- Recovery for two or more years - If the taxpayer received a refund or other recovery that is for amounts paid in two or more separate years, allocate, on a pro rata basis, the recovered amount between the years in which it was paid. Information on allocating these amounts can be found in the Recoveries section of Publication 525.

Itemized Deduction Recoveries

Generally, the full amount recovered from a prior year Schedule A deduction must be included in income the year it is received.

Enter state or local income tax refunds on Schedule 1, line 1, and the total of all other recoveries as other income on Schedule 1, line 8z.

Only the amount of itemized deductions that is more than the standard deduction is subject to the recovery rule, unless the taxpayer is required

to itemize deductions. If the total deductions on the earlier year return was not more than the total income for that year, include in income this year the lesser of the recoveries or the amount by which the itemized deductions exceeded the standard deduction.

If the taxpayer could claim an additional standard deduction for certain taxes or a net disaster loss, increase the standard deduction for that year.

Recovery Limited to Deduction

Do not include in the income any amount of a recovery that is more than the amount deducted in the earlier year. The amount to include in income is limited to the smaller of either the amount deducted on Schedule A (Form 1040 or 1040-SR), or the amount recovered.

Rents from Personal Property

If the taxpayer rents out personal property, such as equipment or vehicles, the income and expenses required to be reported depends on:

- Whether or not the rental activity is a business
- Whether or not the rental activity is conducted for profit

If the primary purpose of renting the property is to produce income or profit and the taxpayer engages in the rental activity with continuity and regularity, the rental activity is a business. The income and expenses are reported on Schedule C.

If the taxpayer is not in the business of renting personal property, report the rental income on Schedule 1, line 8k. Include the rental expenses in the total amount entered on Schedule 1, line 24b.

Royalties

Royalties from copyrights, patents, and oil, gas, and mineral properties are taxable as ordinary income.

In most cases, royalties are reported in Part I of Schedule E; however, if the taxpayer holds an operating oil, gas, or mineral interest or is in business as a self-employed writer, inventor, artist, etc., report income and expenses on Schedule C.

Welfare and Other Public Assistance Benefits

Governmental benefit payments from a public welfare fund (based upon need, such as payments due to blindness), should not be included in income.

Payments from a state fund for the victims of crime should not be included in the victims' incomes if they are in the nature of welfare payments. Do not deduct medical expenses that are reimbursed by such a fund. Also, include in income any welfare payments that are compensation for services or that are obtained fraudulently.

Alternative Trade Adjustment Assistance (ATAA) Payments

Payments received from a state agency under the Demonstration Project for Alternative Trade Adjustment Assistance for Older Workers (ATAA) must be included in the income. The amount to include in income is located on Form 1099-G and should be reported on Schedule 1, line 8z.

Persons with Disabilities

Include in income compensation received for services performed unless the compensation is otherwise excluded. Do not, however, include in income the value of goods, services, and cash received for training and

rehabilitation because of a disability. Excludable amounts include payments for transportation and attendant care, such as interpreter services for the deaf, reader services for the blind, and services to help individuals with an intellectual disability do their work.

Disaster Relief Grants

Do not include post-disaster grants received under the Disaster Relief and Emergency Assistance Act in income if the grant payments are made to help the taxpayer meet necessary expenses or serious needs for medical, dental, housing, personal property, transportation, or funeral expenses.

Disaster Relief Payments

A qualified disaster is:

- A disaster which results from a terrorist or military action
- A federally declared disaster
- A disaster which results from an accident involving a common carrier
- Any event which is determined to be catastrophic by the Secretary of the Treasury or his or her delegate

Exclude from income all qualified disaster relief payments. Exclude payment amounts only to the extent any expense the payments pay for are not paid for by insurance or otherwise.

Other Miscellaneous Income

Home Affordable Modification Program (HAMP)

Benefits from Pay-for-Performance Success Payments under HAMP are not taxable. This program ended in 2016.

Mortgage Assistance Payments

Payments made under section 235 of the National Housing Act for mortgage assistance are not included in the homeowner's income. Interest paid for the homeowner under the mortgage assistance program cannot be deducted.

Medicare

Medicare benefits received under title XVIII of the Social Security Act are not includible in the gross income of the individuals for whom they are paid. This includes basic (part A (Hospital Insurance Benefits for the Aged)) and supplementary (part B (Supplementary Medical Insurance Benefits for the Aged)).

Old-Age, Survivors, and Disability Insurance Benefits (OASDI)

OASDI payments under section 202 of title II of the Social Security Act are not includible in the gross income of the individuals to whom they are paid.

Nutrition Program for the Elderly

Food benefits received under the Nutrition Program for the Elderly are not taxable. If the taxpayer prepares and serves free meals for the program, include in income as wages the cash pay received, even if the taxpayer is also eligible for food benefits.

Activity Not for Profit

Include in the income all payments received from an activity not expected to make a profit. For example, profit from a hobby or a farm operated mostly for recreation and pleasure.

Enter this income on Schedule 1, line 8i.

Campaign Contributions

Contributions are not income to a candidate unless they are diverted to his or her personal use. To be exempt from tax, the contributions must be spent for campaign purposes or kept in a fund for use in future campaigns. However, interest earned on bank deposits, dividends received on contributed securities, and net gains realized on sales of contributed securities are taxable and must be reported on Form 1120-POL, U.S. Income Tax Return for Certain Political Organizations. Excess campaign funds transferred to an office account must be included in the officeholder's income on Schedule 1, line 8, in the year transferred.

Child Support Payments

Child support payments are not reported as income on a return.

Court Awards and Damages

To determine if settlement amounts received must be included in income, consider the item that the settlement replaces. The character of the income as ordinary income or capital gain depends on the nature of the underlying claim.

Do not include in income compensatory damages for personal physical injury or physical sickness (whether received in a lump sum or installments).

Damages received for emotional distress due to a physical injury or sickness are not included in income. If the emotional distress is due to a personal injury that is not due to a physical injury or sickness (for example, employment discrimination or injury to reputation), include the damages in income, except for any damages received for medical care due to that emotional distress.

Fees for Services

Include all fees for services in the income. Examples of these fees are amounts received for services performed as:

- A corporation director - Report these payments on Schedule C.
- An executor, administrator, or personal representative of an estate - Report fees on Schedule 1, line 8z. If the taxpayer is in the trade or business of being an executor, report as self-employment income on Schedule C.
- A manager of a trade or business operated before declaring Chapter 11 bankruptcy - Report this income on Schedule 1, line 8.
- A notary public - Report these payments on Schedule C.

Gambling Winnings

Include gambling winnings in income on Schedule 1, line 8b. If itemizing deductions, deduct gambling losses for the year, but only up to the amount of the winnings.

NOTE: Winnings from lotteries and raffles are gambling winnings. In addition to cash winnings, include in income the fair market value of bonds, cars, houses, and other noncash prizes.

If the taxpayer received Form W-2G, Certain Gambling Winnings, showing the amount of gambling winnings and any tax taken out of them, include the amount from box 1 on Schedule 1, line 8b. Include the amount shown in box 4 on Form 1040 or 1040-SR, line 25c, as federal income tax withheld other forms.

Gifts and Inheritances

In most cases, property received as a gift, bequest, or inheritance is not included in income. If, however, the property produces income such as interest, dividends, or rents, that income is taxable. If property is given to a trust and the income from it is paid, credited, or distributed to the taxpayer, that income is also taxable. If the gift, bequest, or inheritance is the income from the property, that income is also taxable.

Jury Duty

Jury duty pay must be included in income on Schedule 1, line 8g. If the pay is turned over to the employer because the employer continues to pay the taxpayer's salary while serving jury duty, deduct the amount turned over to the employer as an adjustment to income. Enter the amount repaid to the employer on Schedule 1, line 24a.

Medical Savings Accounts (MSAs)

In most cases, do not include in income amounts withdrawn from an Archer MSA or Medicare Advantage MSA if the money is used to pay for qualified medical expenses.

Generally, qualified medical expenses are those that are deductible on Schedule A, Itemized Deductions, which is covered in later in this course.

Prizes and Awards

The fair market value of prizes and awards is reported as income on Schedule 1, line 8h. If the prize is refused, its value does not need to be included in the income.

Cash awards or bonuses given by an employer for good work generally must be included in income as wages. However, certain noncash employee achievement awards may be excluded from income.

There are exceptions for Pulitzer, Nobel, and similar prizes if the recipient directs the money to a tax-exempt charity BEFORE receiving it.

Foreign Accounts and Trusts Reporting Foreign Income

Generally, federal law requires U.S. citizens and resident aliens to report any worldwide income, including income from foreign bank accounts, trusts, and securities. In most cases, affected taxpayers must file Schedule B Part III with their federal tax return.

Schedule B Part III must be completed if one of the following applies:

- The taxpayer has over \$1,500 of taxable interest or ordinary dividends
- The taxpayer has a foreign account
- The taxpayer received a distribution from or was a grantor of, or a transferor to, a foreign trust

In addition to Schedule B, Part III certain taxpayers may also have to file Form 8938, Statement of Special Foreign Financial Assets.

Certain taxpayers, living in the United States, holding foreign financial assets with an aggregate value exceeding \$50,000 (\$100,000 MFJ) on the

last day of the year, or more than \$75,000 (\$150,000 MFJ) at any time must file Form 8938 with their federal tax return. Various levels apply for taxpayers living outside the United States.

If a taxpayer does have a foreign account, he or she may be required to file Financial Crimes Enforcement Network (FinCEN) Form 114, Report of Foreign Bank and Financial Accounts (FBAR) to report financial interest or signature authority. United States persons with a financial interest in or signature authority over at least one financial account located outside of the United States and the aggregate value of all foreign financial accounts exceeding \$10,000 at any time during the calendar year are required to file an FBAR. Exceptions to filing requirements can be found in the FinCEN FBAR instructions.

FinCEN Form 114 (FBAR) is filed with the Financial Crime Enforcement Network (FinCEN) which is a bureau of the Department of Treasury. The FBAR must be filed on or before April 15 of the year following the calendar year being reported. There is normally an automatic extension until October 15th in most cases.

NOTE: Filing Form 8938 does not replace or affect a taxpayer's obligation to file FinCEN Form 114.

General Terms Concerning Foreign Income

A financial account includes, but is not limited to, these types of accounts maintained with a financial institution or other person performing the services of a financial institution:

- Securities
- Brokerage

- Savings
- Demand
- Checking
- Deposit
- Time deposit

A financial account also includes commodity futures or options account, an insurance policy with a cash value, an annuity policy with a cash value, and shares in a mutual fund or similar pooled fund.

A foreign financial account is considered to be located in a foreign country if the account is physically located outside of the United States.

Signature authority is the authority of an individual to control the disposition of assets held in a foreign financial account by direct communication to the bank or other financial institution that maintains the financial account (certain exceptions apply).

2.4 Reporting and Taxability of Retirement Income Including IRAs

Social Security Benefits

Social Security benefits, including monthly retirement, survivor, and disability benefits, might be taxable. Most taxpayers will receive Form SSA-1099, which will report the total benefits.

Several factors determine if any portion of the Social Security benefits are taxable. If the only income the taxpayer received during the tax year is Social Security benefits or equivalent railroad retirement benefits, the benefits might not be taxable, and the taxpayer might not be required to file a tax return.

If a taxpayer received income from other sources, the benefits will generally not be taxable unless the taxpayer's modified adjusted gross income (MAGI) is more than the base amount for the taxpayer's filing status.

Calculating Taxable Portion of Social Security Benefits

To figure the taxable portion of the benefits, compare the base amount for the taxpayer's filing status with the total of:

1. One-half of the benefits
2. All other income, including tax-exempt interest

When making this comparison, do not reduce other income by any exclusion for:

- Interest from qualified U.S. savings bonds
- Employer-provided adoption benefits
- Interest on education loans
- Foreign earned income or foreign housing
- Income earned by bona fide residents of American Samoa or Puerto Rico

To figure the taxable portion of Social Security benefits, compare the base amount for the taxpayer's filing status. The base amounts are:

- \$25,000 if filing Single, Head of Household, or Qualifying Surviving Spouse
- \$25,000 if filing Married Filing Separately and lived apart from the spouse for all the tax year

- \$32,000 if filing Married Filing Jointly
- \$-0- if Married Filing Separately and lived with the spouse at any time during the year

2.5 IRAs, Pensions, and Annuities

Distributions from IRAs, pensions, annuities, and other retirement plans are usually reported to the taxpayer on Form 1099-R and might be fully or partially taxable.

Retirement income is generally classified as one of the following types:

- Pension
- Annuity
- IRA

Distributions from IRAs, pensions, and annuities are fully taxable if the taxpayer has no investment in the contract because any of the following situations could apply:

- Taxpayer did not contribute anything nor was considered to have contributed anything for the pension or annuity
- Employer did not withhold contributions from employee's salary
- Taxpayer received all their contributions tax free in prior years

If the taxpayer contributed after-tax dollars to his or her pension or annuity, the distributions are partially taxable. Tax will not be imposed upon the part of the distribution which represents a return of after-tax amounts paid into the plan.

If a distribution was made before the taxpayer reached age 59 ½, it is considered to be an early distribution. An additional 10% tax is imposed upon early distributions unless qualified for an exception.

Pension

A pension is generally a series of determinable payments made to a taxpayer after he or she retires from work. Pension payments are made regularly and are based on such factors as years of service and prior compensation. Disability pensions normally begin when a taxpayer is disabled before retirement age.

Annuity

An annuity is a series of payments under a contract made at regular intervals over a period of more than one full year. Annuities can be either fixed (under which the taxpayer receives a definite amount) or variable (not fixed). Taxpayers can buy the contract alone or with the help of their employer.

Pensions and annuities include the following types:

- Fixed-period annuities - Taxpayers receive definite amounts at regular intervals for a specified length of time.
- Annuities for a single life - Taxpayers receive definite amounts at regular intervals for life. The payments end at death.
- Joint and survivor annuities - The first annuitant receives a definite amount at regular intervals for life. After he or she dies, a second annuitant receives a definite amount at regular intervals for life. The amount paid to the second annuitant might or might not differ from the amount paid to the first annuitant.

- Variable annuities - Taxpayers receive payments that may vary in amount for a specified length of time or for life. The amounts received might depend upon such variables as profits earned by the pension or annuity funds, or cost-of-living indexes.
- Disability pensions - Taxpayers receive disability payments because he or she has retired on disability but has not reached the minimum retirement age.

Individual Retirement Arrangements (IRAs)

An Individual Retirement Arrangement, or IRA, is a personal savings plan that allows taxpayers to set aside money for retirement, while offering them tax advantages. Taxpayers might be able to deduct some or all their contributions to an IRA and could also be eligible for a tax credit equal to a percentage of their contribution. Amounts in an IRA, including earnings, generally are not taxed until distributed. IRAs cannot be owned jointly, but any amounts remaining in an IRA upon the taxpayer's death can be paid to a named beneficiary or beneficiaries.

There are four kinds of IRAs, each with different tax implications:

- Traditional IRA - Distributions from traditional IRAs are fully taxable unless nondeductible contributions have been made.
- Roth IRA - Distributions from a Roth IRA are tax-free and can be excluded from income if certain requirements are met.
- Savings Incentive Match Plans for Employees (SIMPLE) IRA - Generally, SIMPLE IRA contributions are not included in an employee's income when paid into an IRA and the distributions are fully taxable when the employee receives them in later years.

- Simplified Employee Pension (SEP) IRA - Generally, SEP IRA contributions are not included in an employee's income when paid into the IRA. Distributions are generally fully taxable when the employee receives them in later years.

Example:

Johnson did not have a retirement plan at her job. Every year she contributed \$500 to a traditional IRA. Each year Johnson deducted her traditional IRA contribution from her income. This year, she received her first distribution from the traditional IRA which is fully taxable. Johnson will pay income tax on the distribution she receives (which represents the contributions she made and deducted) and the earnings on the contributions.

Retirement Income Reporting Statements

Payers of retirement income report benefits on various forms such as:

- Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
- Form CSA 1099-R, Statement of Annuity Paid (civil service retirement payments)
- Form CSF 1099-R, Statement of Survivor Annuity Paid

General Information about Retirement Plans - Receiving Benefits from More than One Program

For taxpayers who received benefits from more than one program under a single trust or plan of his or her employer, such as a pension plan and a profit-sharing plan, figure the taxable part of each pension or annuity contract separately.

Section 457 Deferred Compensation Plans

Taxpayers who work at a state or local government or tax-exempt organization might be able to participate in a section 457 deferred compensation plan, if eligible. Eligible plans are not taxed currently on pay that is deferred under the plan or on any earnings from the plan's investment of the deferred pay. Amounts deferred in an eligible state or local government plan are taxed only when distributed from the plan, and only when made available to the taxpayer.

Disability Pensions

Generally, taxpayers who retire on disability must include in their income any disability pension received under a plan paid for by the employer. Report taxable disability payments as wages on line 1 of Form 1040 or 1040-SR until the taxpayer reaches the minimum retirement age. Once the minimum retirement age is reached, payments received are taxable as a pension or annuity on Form 1040 or 1040-SR.

Retired Public Safety Officers

An eligible retired public safety officer can elect to exclude from income distributions of up to

\$3,000 made directly from a government retirement plan to the provider of accident, health, or long-term disability insurance.

Withholding and Estimated Tax

The payer of the pension, profit-sharing, stock bonus, annuity, or deferred compensation plan withholds income tax on the taxable parts of amounts paid to the taxpayer. Taxpayers may choose how much to withhold by

filing Form W-4P. If no tax or not enough tax is withheld, it may be necessary for the taxpayer to pay the estimated tax.

Generally, a mandatory 20% tax is withheld from an eligible rollover distribution paid to a taxpayer from an employer-sponsored plan. No tax is normally withheld on a direct rollover of an eligible rollover distribution.

Qualified Plans for Self Employed Individuals

Qualified plans set up by self-employed individuals are sometimes called Keogh or H.R. 10 plans. Qualified plans can be set up by sole proprietors, partnerships (but not a partner), and corporations. Plans can cover self-employed persons, such as the sole proprietor, partners, and regular (common-law) employees.

Distributions from a qualified plan are usually fully taxable because most recipients have no cost basis. If the taxpayer has an investment (cost) in the plan, however, the pension or annuity payments from a qualified plan are taxed under the Simplified Method, covered later in this course.

Purchased Annuities

In most cases, the General Rule (covered later) is used to figure the tax-free part of annuity payments from a privately purchased annuity contract from a commercial organization, such as an insurance company.

Loans and Tax-Free Exchanges

If money is borrowed from the retirement plan, treat the loan as a nonperiodic distribution from the plan unless certain exceptions apply. Include in the income all or part of the amount borrowed.

Tax-Free Exchange

No gain or loss is recognized on an exchange of an annuity contract for another annuity contract if the insured or annuitant remains the same. If, however, an annuity contract is exchanged for a life insurance or endowment contract, any gain due to interest accumulated on the contract is ordinary income.

Figuring Cost of Plan

Before figuring out how much, if any, of a distribution from a pension or annuity plan is taxable, the cost of the pension or annuity must be determined.

The cost is the investment the taxpayer has made in the contract, and includes the total premiums, contributions, or other amounts paid. This also includes employer contributions taxable to the taxpayer when paid. Cost does not include any amounts deducted or excluded from income.

From this total cost, subtract any refunds of premiums, rebates, dividends, unrepaid loans not included in income, or other tax-free amounts received by the latter of the annuity starting date or the date on which the first payment was received.

The annuity starting date is the later of the first day of the first period for which a payment is received and the date the plan's obligations became fixed.

Designated Roth Accounts

The cost in these accounts is the designated Roth contributions included in income as wages subject to applicable withholding requirements. The cost also includes any in-plan Roth rollovers included in the income.

Foreign Employment Contributions

If the taxpayer worked in a foreign country and contributions were made to his or her retirement plan, special rules apply in determining cost. See Publication 575.

Fully Taxable Payments

Generally, if the taxpayer did not pay any part of the cost of an employee pension or annuity and the employer did not withhold part of the cost from the taxpayer's pay, the amounts received each year are fully taxable and must be reported as income on the tax return.

Taxation of Periodic Payments

If the taxpayer paid part of the cost of the pension or annuity, the part of the pension or annuity received which represents a return of the cost is not taxable. The rest of the amount received is generally taxable. Figure the tax-free part of the payment using either the Simplified Method or the General Rule (both covered later). The annuity starting date and whether or not the plan is qualified determines which method to use.

- If the annuity starting date is after November 18, 1996, and payments are from a qualified plan, use the Simplified Method.
- The General Rule must be used if the annuity is paid under a nonqualified plan. It is not used if the annuity is paid under a qualified plan.
- If the annuity is paid under a qualified plan and the annuity starting date is after July 1, 1986, and before November 19, 1996, use either the General Rule or the Simplified Method.

- For taxpayers with more than one taxable pension or annuity, figure the tax-free part and the taxable part of each separately.

Exclusion Limit

The annuity starting date determines the total amount of annuity payments that can be excluded from taxable income over the years. Once the annuity starting date is determined, it does not change.

If calculating the taxable portion of annuity payments using the simplified method worksheet, the annuity starting date determines the recovery period for the taxpayer's cost. That recovery period begins on the annuity starting date.

Exclusion limited to cost - If the annuity starting date is after 1986, the total amount of annuity income that can be excluded over the years as a recovery of the cost cannot exceed the total cost. Any unrecovered cost at the taxpayer's (or the last annuitant's) death is allowed as a miscellaneous itemized deduction on the final return of the decedent.

Exclusion not limited to cost - If the annuity starting date is before 1987, the taxpayer can continue to take a monthly exclusion for as long as the annuity is received. For a joint and survivor annuity, the survivor can continue to take the survivor's exclusion figured as of the annuity starting date. The total exclusion may be more than the cost.

Calculating Taxable Portion

Taxpayers should use either the Simplified Method or the General Rule to calculate the taxable portion of annuity payments.

The Simplified Method should be used if the annuity starting date is after November 18, 1996, and both of the following are true:

- Taxpayer receives pension or annuity payments from a qualified employee plan, qualified employee annuity, or a tax-sheltered annuity (403(b)) plan
- On the annuity start date the taxpayer was either under age 75 or entitled to fewer than five years of guaranteed payments

The General Rule is generally used to determine the tax treatment of pension and annuity income from nonqualified plans, or qualified plan if taxpayer is 75 or older on the annuity starting date and the annuity payments are guaranteed for at least 5 years. The General Rule generally can be used only for qualified plans if the annuity start date was after July 1, 1986, and before November 19, 1996. For more information on the General Rule, see Publication 939, General Rule for Pensions and Annuities.

Simplified Method

Under the Simplified Method, figure the taxable and tax-free parts of annuity payments by completing the Simplified Method Worksheet, available in IRS Publication 575, which divides the cost by the total number of anticipated monthly payments.

$$\boxed{\text{Cost} \div \text{Number of monthly payments} = \text{monthly tax-free portion}}$$

For an annuity that is payable for the lives of the annuitants, the number of payments is based on the annuitants' ages on the annuity starting date and is determined from a table. For any other annuity, this number is the number of monthly annuity payments under the contract.

Taxation on Nonperiodic Payments

Nonperiodic distributions are also known as amounts not received as an annuity and include all payments other than periodic payments and corrective distributions.

Examples of nonperiodic payments are cash withdrawals, distributions of current earnings, certain loans, and the value of annuity contracts transferred without full and adequate consideration.

The taxable amount of a nonperiodic distribution depends on whether it is made before the annuity starting date, or on or after the annuity starting date.

If it is made before the annuity starting date, its tax treatment also depends on whether it is made under a qualified or nonqualified plan. If it is made under a nonqualified plan, taxability depends on whether it fully discharges the contract, is received under certain life insurance or endowment contracts, or is allocable to an investment made before August 14, 1982.

The annuity starting date is either the first day of the first period for which an annuity payment is received under the contract, or the date on which the obligation under the contract becomes fixed, whichever is later.

Distribution on or after annuity starting date - If a nonperiodic payment is received from an annuity contract on or after the annuity starting date, all the payment is generally included in gross income.

Distribution before annuity starting date - If a nonperiodic distribution is received before the annuity starting date from a qualified retirement plan, allocate only part of it to the cost of the contract. Exclude from gross

income the part allocated to the cost and include the remainder in gross income.

Lump-Sum Distributions (For Participants Born Before January 2, 1936)

NOTE: The following information about lump-sum distributions applies only if the plan participant was born before January 2, 1936. If the plan participant was born after January 1, 1936, the taxable amount of this nonperiodic payment is reported as discussed earlier.

A lump-sum distribution is the distribution or payment in one tax year of a plan participant's entire balance from all the employer's qualified plans of one kind (for example, pension, profit-sharing, or stock bonus plans). A distribution from a nonqualified plan cannot qualify as a lumpsum distribution.

Use Form 4972, Tax on Lump Sum Distributions, to figure the separate tax on a lump-sum distribution using the optional methods. The tax figured on Form 4972 is added to the regular tax figured on the taxpayer's other income. This could result in a smaller tax than would normally be paid by including the taxable amount of the distribution as ordinary income in figuring regular tax.

The taxable portion of a lump-sum distribution can be treated in one of the following ways (if the taxpayer qualifies):

- Report the part of the distribution from participation before 1974 as a capital gain and the part from participation after 1973 as ordinary income.

- Report the part of the distribution from participation before 1974 as a capital gain and use the 10-year tax option to figure the tax on the part from participation after 1973.
- Use the 10-year tax option to figure the tax on the total taxable amount.
- Roll over all or part of the distribution, discussed later in this course. No tax is currently due on the part rolled over. Report any part not rolled over as ordinary income.
- Report the entire taxable part of the distribution as ordinary income on the tax return.

Taxable and Tax-Free Parts of the Distribution

The taxable part of a lump-sum distribution is the employer's contributions and income earned on the account. Recover the cost in the lump sum and any net unrealized appreciation (NUA) in employer securities tax free.

In general, the taxpayer's cost is the sum of:

- The plan participant's nondeductible contributions to the plan
- The plan participant's taxable costs of any life insurance contract distributed
- Any employer contributions that were taxable to the plan participant
- Repayments of any loans which were taxable to the plan participant
These costs must be reduced by amounts previously distributed tax free. Capital Gain Treatment

Capital gain treatment applies only to the taxable part of a lump-sum distribution resulting from participation in the plan before 1974. The amount treated as capital gain is taxed at a 20% rate. Elect this treatment only once for any plan participant, and only if the plan participant was born before January 2, 1936.

10-Year Tax Option

The 10-year tax option is a special formula used to figure a separate tax on the ordinary income part of a lump-sum distribution. The tax is paid only once, in the year the distribution was received, not over 10 years. This election can only be made once per taxpayer after 1986, and only if the plan participant was born before January 2, 1936.

IRA Rollovers

Most distributions received from an IRA before retirement age can be “rolled over” by depositing the distribution in another retirement plan or IRA (or depositing back into the same account) within 60 days. Most financial institutions can deposit distributions directly into another plan or IRA, in a trustee-to-trustee transfer. Usually if the distribution is deposited into an IRA within the 60-day limit, it is tax free. If the deadline is missed, taxpayers might owe tax and penalties on the distribution.

Review IRS Publications 590-A and 590-B for specific rules and requirements for IRAs and rollovers.

One-Rollover-Per-Year Rule

Prior to 2015, the IRS applied an IRA-by-IRA limit on the 60-day rollover which allowed only one rollover per IRA in a 12-month period. Individuals often used rollovers as a “temporary loan” which was to be repaid within 60 days; and often found themselves taking a distribution

from another IRA in order to “repay” the first IRA within the 60 days, thus beginning a second 60-day period in order to pay back the “loan”.

Starting in January 2015, the IRS began enforcing new rules which allow taxpayers to rollover only one distribution per year, no matter how many IRAs the taxpayer owns. This comes after a tax court ruling in the case of *Bobrow v. Commissioner*, which expanded the interpretation of the once per-year rollover rules. The court determined that only one rollover is allowed every 365 days on an aggregate basis rather than an account-by-account basis that had been previously used.

Aggregate of IRAs

The 12-month limit applies by aggregating, or combining, all IRAs owned by an individual, treating them as one IRA for the purpose of the rollover limit. These IRAs include:

- SEP
- SIMPLE
- Traditional
- Roth

Rollovers from traditional to Roth IRAs (conversions) are not limited, but may be subject to income tax, however the conversion will not be subject to the early distribution penalties.

Example:

Jessica has two traditional IRAs: IRA 1 and IRA 2. Jessica takes a \$5,000 distribution from IRA 1 on March 15, 2024. To avoid tax and penalties, Jessica must pay back or “rollover” \$5,000 into either IRA within 60 days.

Jessica cannot take a distribution from IRA 2 to pay back IRA 1 without paying taxes and penalties on the second distribution, even if paid back within 60 days. She must wait 365 days before taking another distribution from either IRA 1 or IRA 2.

ROTH Recharacterizations

Prior to the TCJA, a taxpayer could elect to recharacterize a contribution made to one type of IRA as having been made to a different type of IRA.

For tax years beginning after December 31, 2017, the rule allowing the IRA recharacterization from conversions no longer applies. A conversion from a traditional, SEP, or SIMPLE IRA to a ROTH IRA cannot be recharacterized. The new provision also prohibits recharacterizing amounts rolled over to a ROTH IRA from other retirement plans such as a 401(k) and 403 (b) plans.

Additional Taxes

Additional taxes are imposed on the early distribution of pension funds and on the failure to withdraw pension funds in a timely manner. In most cases, taxpayers are not subject to additional taxes if early distributions are rolled over, and the withdrawing of funds begins at a normal retirement age, in reasonable amounts, over the taxpayer's life expectancy.

Special additional taxes are taxes imposed on the following:

- Early distributions
- Excess accumulation (not receiving minimum distributions)

Early Distributions

Most distributions (both periodic and nonperiodic) from qualified retirement plans and deferred annuity contracts made before the taxpayer reaches age 59½ are subject to an additional tax of 10%. This tax applies to the part of the distribution that must be included in gross income.

For this purpose, a qualified retirement plan is:

- A qualified employee plan under section 401(a), such as a section 401(k) plan
- A qualified employee annuity plan under section 403(a)A tax-sheltered annuity plan under section 403(b) for employees of public schools or tax-exempt organizations, or
- An individual retirement account under section 408(a) or an individual retirement annuity under section 408(b) (IRAs)

In general, an eligible state or local government section 457 deferred compensation plan is not a qualified retirement plan and any distribution from such plan isn't subject to the 10% additional tax on early distributions. However, any distribution attributable to amounts the section 457 plan received in a direct transfer or rollover from one of the qualified retirement plans listed above would be subject to the 10% additional tax.

Distributions from Roth IRAs allocable to a rollover from an eligible retirement plan within the five-year period

If within the five-year period starting with the first day of the tax year in which the taxpayer rolled over an amount from an eligible retirement plan to a Roth IRA, he or she takes a distribution from the Roth IRA, the

taxpayer might have to pay the additional 10% tax on early distributions. 10% additional tax must be paid on any amount attributable to the part of the rollover that was included in the income.

The same rule applies to distributions from designated Roth accounts allocable to in-plan Roth rollovers within the five-year period.

Early Distribution Exceptions (Qualified Plans)

Distributions that are not taxable, such as distributions that you roll over to another qualified retirement plan, aren't subject to the 10% additional tax.

- There are certain exceptions to this 10% additional tax. The exceptions below apply to distributions from a qualified plan other than an IRA.
- Distributions made to your beneficiary or estate on or after your death.
- Distributions made because you are totally and permanently disabled.
- Distributions made as part of a series of equal periodic payments over your life expectancy or the life expectancies of you and your designated beneficiary. If these distributions are from a qualified plan other than an IRA, you must separate from service with this employer before the payments begin for this exception to apply.
- Distributions to the extent you have deductible medical expenses that exceed 7.5% of your adjusted gross income whether you itemize your deductions for the year. For more information on medical expenses, refer to Topic No. 502.
- Distributions made due to an IRS levy of the plan under section 6331.

- Distributions that are qualified reservist distributions. Generally, these are distributions made to individuals called to active duty for at least 180 days after September 11, 2001.
- Distributions that are excepted from the additional income tax by federal legislation relating to certain emergencies and disasters.
- Distributions up to \$5,000 made to you from a defined contribution plan or an IRA if the distribution is a qualified birth or adoption distribution.
- Distributions made to you after you separated from service with your employer if the separation occurred in or after the year you reached age 55, or distributions made from a qualified governmental benefit plan, as defined in section 414(d) if you were a qualified public safety employee (federal state or local government) who separated from service in or after the year you reached age 50.

Distributions made to an alternate payee under a qualified domestic relations order.

- Distribution of dividends from employee stock ownership plans.

Early Distribution Exceptions (Traditional IRAs)

Early distribution of taxable amounts from a traditional IRA should be included in gross income. Early distributions are also subject to an additional 10% tax, as discussed later.

Early distributions are generally amounts distributed from a traditional IRA account or annuity before the taxpayer is age 59½, or amounts received when retirement bonds are cashed before the taxpayer is age 59½.

Exceptions

There are several exceptions to the age 59½ rule. Even if the taxpayer receives a distribution before they are age 59½, they may not have to pay the 10% additional tax if they are in one of the following situations.

- The taxpayer has unreimbursed medical expenses for the taxpayer, spouse, and dependents, which are more than 7.5% of their adjusted gross income.
- The distributions are not more than the cost of the taxpayer's medical insurance due to a period of unemployment. Conditions include job loss, receiving unemployment compensation for more than 12 consecutive weeks, and specific timing rules of the distribution as related to unemployment.
- The taxpayer is totally and permanently disabled.
- The taxpayer is the beneficiary of a deceased IRA owner.
- The taxpayer is receiving distributions in the form of an annuity.
- They can receive distributions from their traditional IRA that are part of a series of substantially equal payments over their life (or their life expectancy), or over the lives (or the joint life expectancies) of the taxpayer and their beneficiary, without having to pay the 10% additional tax, even if they receive such distributions before they are age 59½. Taxpayers must use an IRS-approved distribution method, and they must take at least one distribution annually for this exception to apply. The "required minimum distribution method," when used for this purpose, results in the exact amount required to be distributed, not the minimum amount.

- The distributions are not more than the taxpayer's qualified higher education expenses. Qualified higher education expenses are tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a student at an eligible educational institution.
- The taxpayer uses the distributions to buy, build, or rebuild a first home. The limit is

\$10,000. A first-time homebuyer is defined as a taxpayer who had no present interest in a main home during the two-year period ending on the date of the acquisition of the home which the distribution is being used to buy, build, or rebuild.

- The distribution is due to an IRS levy of the qualified plan.
- The distribution is a qualified reservist distribution. Distributions after September 11, 2001, must be made no earlier than the date of the order or call to active duty, and no later than the close of the active-duty period. The active-duty period must be more than 179 days.
- The distribution is a qualified birth or adoption distribution, up to \$5,000 per adoption or birth. The adoptee must be under 18 or physically or mentally incapable of self-support.

The distribution from an applicable eligible retirement plan must be made during the 1- year period beginning on the date on which the adoptee was born, or the date on which the legal adoption of the adoptee was finalized.

Reporting the 10% Additional Tax

Calculate the 10% additional tax on Form 5329, Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts if:

- The distribution is subject to the tax and distribution code 1 isn't shown in the appropriate box of Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., or
- One of the exceptions applies but the box labeled "Distribution Code(s)" does not show a distribution code 2, 3, or 4.

Form 5329 is not required if the distribution is subject to the 10% additional tax and a distribution code 1 shows in the appropriate box. In this case, enter the 10% additional tax on line 8 of Schedule 2 (Form 1040), Additional Taxes and write "No" on the dotted line next to that line.

Excess Accumulations (Insufficient Distributions) Qualified Plans

Payments received from qualified retirement plans must begin no later than the required beginning date and the payments each year cannot be less than the required minimum distribution. These rules are in place to make sure that most retirement benefits are paid to the participant during the lifetime of the recipient rather than to the beneficiaries after the recipient's death.

If the actual distributions in any year are less than the minimum required distribution for that year, the taxpayer is subject to an additional tax.

Secure Act 2.0 reduces the tax from 50% to 25% of the part of the required minimum distribution that was not distributed.

For this purpose, a qualified retirement plan includes:

- A qualified employee plans
- A qualified employee annuity plan
- An eligible section 457 deferred compensation plan
- A tax-sheltered annuity plan (403(b) plan for benefits accruing after 1986)

NOTE: The tax might be waived if the taxpayer establishes that the shortfall in distributions was due to reasonable error and that reasonable steps are being taken to remedy the shortfall.

Unless the rule for 5% owners applies, the taxpayer must begin to receive distributions from a qualified retirement plan by April 1 of the year that follows the later of:

- The calendar year in which he or she reaches age 73 (72 for 2022)
- The calendar year in which he or she retires from employment with the employer maintaining the plan

Some plans require distributions to begin by April 1 of the year that follows the year in which the taxpayer reaches age 73 (72 for 2022) even if he or she has yet to retire; 5% owners are required to begin receiving distributions by April 1 of the year that follows the calendar year in which he or she reaches age 73 (72 for 2022).

By the required beginning date, the taxpayer must either receive the entire interest in the plan or begin receiving periodic distributions in annual amounts calculated to distribute the entire interest over his or her life or

life expectancy or over the joint lives or joint life expectancies of the taxpayer and a designated beneficiary (or over a shorter period).

Excess Accumulations (Insufficient Distributions) IRAs

Payments received from traditional IRAs must begin no later than the required beginning date and the payments each year cannot be less than the required minimum distribution. Generally, taxpayers must begin receiving distributions by April 1 of the year following the year in which they reach age 73 (72 if taxpayer reached 72 before January 1, 2024). The required minimum distribution for any year after the year in which you reach age 73 must be made by December 31 of that later year.

If the actual distributions in any year are less than the minimum required distribution for that year, the taxpayer is subject to an additional tax.

Secure Act 2.0 reduces the tax from 50% to 25% of the part of the required minimum distribution that was not distributed.

For this purpose, a traditional IRA plan includes:

- A traditional IRA with deductible and non-deductible contributions
- A SEP-IRA (Self-employed person IRA)
- A SIMPLE IRA

NOTE: The tax might be waived if the taxpayer establishes that the shortfall in distributions was due to reasonable error and that reasonable steps are being taken to remedy the shortfall.

There are also limited exemptions listed in Revenue Procedure 92-10 in Cumulative IRS Bulletin 1992-1.

Reporting the 50% Additional Excise Tax

Calculate the 50% additional tax on Form 5329, Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts. To request a waiver, attach a statement of explanation and complete Form 5329 as instructed under Waiver of tax for reasonable cause in the Instructions for Form 5329.

Excess Contributions IRAs

An excess IRA contribution occurs if a taxpayer:

- Contributes more than the contribution limit.
- Make a regular IRA contribution for 2019, or earlier, to a traditional IRA at age 70½ or older.
- Make an improper rollover contribution to an IRA.

Excess contributions are taxed at 6% per year for each year the excess amounts remain in the IRA. The tax can't be more than 6% of the combined value of all a taxpayer's IRAs as of the end of the tax year. To avoid the 6% tax on excess contributions, the taxpayer must withdraw:

- the excess contributions from their IRA by the due date of their individual income tax return (including extensions); and
- any income earned on the excess contribution.

See Publication 590-A for certain conditions that may allow you to avoid including withdrawals of excess contributions in gross income.

Qualified Charitable Distributions from IRAs

Generally, a qualified charitable distribution is an otherwise taxable distribution from an IRA (other than an ongoing SEP or SIMPLE IRA)

owned by an individual who is age 70½ or over that is paid directly from the IRA to a qualified charity. Qualified charitable distributions can satisfy all or part of the amount of a taxpayer's required minimum distribution from their IRA.

Charitable distributions are reported on Form 1099-R for the calendar year the distribution is made.

Reporting a qualified charitable distribution

Report the full amount of the charitable distribution on the line for IRA distributions on Form 1040. On the line for the taxable amount, enter zero if the full amount was a qualified charitable distribution. Enter "QCD" next to this line.

The taxpayer must also file Form 8606, Nondeductible IRAs, if:

- a qualified charitable distribution was made from a traditional IRA in which the taxpayer had basis and received a distribution from the IRA during the same year, other than the qualified charitable distribution; or
- the qualified charitable distribution was made from a Roth IRA.

2.6 Reporting and Taxability of Unemployment Compensation

Unemployment compensation includes amounts received under the employment compensation laws of the United States or of a state including:

- State unemployment insurance benefits
- Benefits paid to a taxpayer by a state or the District of Columbia from the Federal Unemployment Trust Fund

- Railroad unemployment compensation benefits
- Disability benefits paid as a substitute for unemployment compensation
- Trade readjustment allowances under the Trade Act of 1974
- Unemployment assistance under the Disaster Relief and Emergency Assistance Act of 1974
- Benefits from a private fund if you voluntarily gave money to the fund and you get more money than what you gave to the fund

Amounts received as unemployment compensation must be included in gross income for Forms 1040 and 1040-SR, Schedule 1, line 7. Unless federal tax is withheld from payments, it is sometimes necessary for the taxpayer to pay quarterly estimated tax payments. Generally, taxpayers should receive Form 1099-G showing the amounts paid and any amount of tax withheld.

2.7 Alimony (divorce agreement executed before 2018; executed after 2018; and modified after 2018)

Before the TCJA was enacted, payments received as alimony and separate maintenance were considered income and the payor spouse could deduct these payments from gross income.

Under the new Act, the alimony deduction by payor and inclusion by payee has been suspended. For payments required under divorce or separation agreements executed after December 31, 2018, there is no deduction for payments as alimony; likewise, alimony received is not taxable income.

If a divorce or separation is executed on or before December 31, 2018, but later modified, the new TCJA rules can apply if the modification:

- changes the terms of the alimony or separate maintenance payments; and
- states that the alimony or separate maintenance payments are not deductible by the payer spouse or includable in the income of the receiving spouse.

2.8 Schedule C. Self-Employment Income

Self-employed taxpayers must file Schedule C to report their profit or loss from a business. A taxpayer is considered self-employed if he or she is:

- Carrying on a trade or business as a sole proprietor
- An independent contractor
- A member of certain partnerships
- In business for himself or herself in any other way
- Single-member LLC
- Member of qualified joint venture

Self-employment can include work in addition to regular full-time business activities, such as certain part-time work done at home or in addition to a regular job.

For taxpayers who own more than one business, a separate Schedule C must be completed for each business.

2.8.1 Determination of gross income & deductions

Use Schedule C to report the following gross receipts:

- Income received from business activity
- Goods or services received through bartering
- Wages and expenses received as a statutory employee
- Income and deductions of certain qualified joint ventures
- Certain Forms 1099-NEC, Nonemployee Compensation
- Certain Forms 1099-K, Payment Card, and Third-Party Network Transactions

Statutory Employees

If the taxpayer received a Form W-2 with the "Statutory employee" box 13 checked, report the income and expenses related to that income on Schedule C. Because Social Security and Medicare tax should have been withheld from those earnings, no self-employment tax on these earnings is owed.

Note: If there was both self-employment income and statutory employee income, two Schedules C must be filed. Do not combine these amounts on a single Schedule C.

Businesses Owned and Operated by Spouses

A taxpayer and spouse who jointly own and operate an unincorporated business and share in the profits and losses are considered partners in a partnership, whether there is a formal partnership agreement. Use Form 1065 instead of Schedule C in these cases, unless one of two exceptions applies.

Exception: Community Income

If you and your spouse own an unincorporated business as community property under the community property laws of a state, foreign country, or U.S. possession, you can treat the business either as a sole proprietorship or a partnership. States with community property laws include Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. A change in your reporting position will be treated as a conversion of the entity.

Exception: Qualified Joint Venture

A taxpayer and spouse who each materially participate as the only members of a jointly owned and operated business and file a joint return for the tax year can elect to be taxed as a qualified joint venture instead of a partnership. By making the election, the taxpayers are not required to file Form 1065 and will instead report the income and deductions directly on the joint return.

To make this election, divide all items of income, gain, loss, deduction, and credit attributable to the business between the taxpayer and spouse in accordance with respective interests in the venture. Each taxpayer must file a separate Schedule C or F. Each must also file a separate Schedule SE to pay self-employment tax, as applicable.

1099-NEC Income

Form 1099-NEC reports payments made during a trade or business. Usually, payers will not issue Form 1099-NEC for payments less than \$600; however, taxpayers must report all income earned as an independent contractor or from informal side jobs as self-employment income even if Form 1099-NEC is not received.

Payments reported on Form 1099-NEC and any other amounts received in trade or business should be included in gross receipts on Schedule C.

Material Participation

On Schedule C, taxpayers should indicate if they “materially participated” in the operation of the business. The taxpayer materially participated in the business if he or she was involved on a regular, continuous, and substantial basis in its operations.

For purposes of the passive activity rules, the taxpayer materially participated in the operation of this trade or business activity if they met any of the following seven tests.

- Participated in the activity for more than 500 hours during the tax year.
- Participation in the activity for the tax year was all the participation in the activity of all individuals (including individuals who did not own any interest in the activity) for the tax year.
- Participated in the activity for more than 100 hours during the tax year and participated at least as much as any other person for the tax year. This includes individuals who did not own any interest in the activity.
- The activity is a significant participation activity for the tax year, and taxpayers participated in all significant participation activities for more than 500 hours during the year. An activity is a “significant participation activity” if it involves the conduct of a trade or business, the taxpayer participated in the activity for more than 100 hours during the tax year, and the taxpayer did not materially participate under any of the material participation tests (other than this test 4).

- Taxpayer materially participated in the activity for any 5 of the prior 10 tax years.
- The activity is a personal service activity in which the taxpayer materially participated for any 3 prior tax years. A personal service activity is an activity that involves performing personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or any other trade or business in which capital is not a material income-producing factor.
- Based on all the facts and circumstances, the taxpayer participated in the activity on a regular, continuous, and substantial basis for more than 100 hours during the tax year. Participation in managing the activity does not count in determining if taxpayer met this test if any person (except taxpayer) (a) received compensation for performing management services in connection with the activity, or (b) spent more hours during the tax year than taxpayer spent performing management services in connection with the activity (regardless of whether the person was compensated for the services).

If the taxpayer did not materially participate in the business, the losses and credits from the business may be used, with certain exceptions, only against income from other passive activities. In that case, complete Form 8582, Passive Activity Loss Limitations, to figure the amount of the loss to enter on the Schedule C.

2.8.2 Business versus Hobby

Taxpayers should be aware of guidelines when determining whether engagement in an activity is a hobby or for profit, such as a business or investment activity.

To make this determination, taxpayers should consider the following factors:

- The taxpayer conducts activity in a businesslike manner and maintains complete and accurate books and records.
- The taxpayer puts time and effort into the activity to show they intend to make it profitable.
- The taxpayer depends on income from the activity for their livelihood.
- The taxpayer has personal motives for conducting the activity such as general enjoyment or relaxation.
- The taxpayer has enough income from other sources to fund the activity
- Losses are due to circumstances beyond the taxpayer's control or are normal for the startup phase of their type of business.
- There is a change to methods of operation to improve profitability.
- Taxpayers and their advisor have the knowledge needed to conduct the activity as a successful business.
- The taxpayer was successful in making a profit in similar activities in the past.
- Activity makes a profit in some years and how much profit it makes.
- The taxpayer can expect to make a future profit from the appreciation of the assets used in the activity.

All factors, facts, and circumstances with respect to the activity must be considered. No one factor is more important than another.

The IRS considers an activity for profit if it makes a profit at least three of the last five tax years (including the current year) and at least two of the last seven years for activities that are primarily breeding, showing, training, or racing horses.

Taxpayers who realize a loss incurred in the operation of an activity or business are allowed to deduct the loss from income; however, if the business or activity is considered a hobby, taxpayers cannot use a loss to offset income.

Self-Employment Expenses

Certain allowable expenses incurred conducting a trade or business can be deducted from the gross profits on Schedule C.

These expenses include but are not limited to:

- Car and Truck Expenses
- Contract Labor
- Depreciation
- Insurance Premiums
- Legal and Professional Fees
- Offices Expenses
- Rents
- Repairs and Maintenance
- Supplies
- Taxes and Licenses
- Utilities

- Business Use of Home
- Advertising
- Commissions and Fees

Car and Truck Expenses

Taxpayers who use a car or truck for business purposes can usually deduct car expenses. One of the two following methods can be used to calculate deductible expenses:

- Standard mileage rate
- Actual expenses

The standard mileage rate is a flat rate per mile that can be used to figure the deductible cost of operating a car or truck for business. For 2024, the standard mileage rate is 65.5 cents per mile. If the standard mileage rate is used, actual expenses cannot be deducted for the same year.

In November of 2019, the IRS released Rev Proc 2019-46 to update standard mileage rules to comply with the Tax Cuts and Jobs Act (TCJA). This new revenue procedure provides rules for using optional standard mileage rates for calculating deductible expenses for automobile use for business, charitable, medical, and moving purposes. Rev Proc 2019-46 modifies and supersedes guidance from Rev Proc 2010-51.

For more information, review Rev. Proc 2019-46.

Listed below are some of the key modifications in Rev Proc 2019-46.

- Taxpayers cannot claim a miscellaneous itemized deduction using the business standard mileage rate.
- Taxpayers cannot claim parking and tolls attributable to the taxpayer's use of an automobile for business purposes as a miscellaneous itemized deduction.
- Taxpayers must reduce the basis of automobiles used in business by the depreciation claimed or allowable for the automobile. If the business standard mileage rate is used, a per-mile amount will be depreciation claimed or allowable.
- Deductions for moving expenses are not allowed unless the taxpayer is a member of the Armed Forces on active duty moving pursuant to a military order and incident to a permanent change of station.

If taxpayers do not use the standard mileage rate, they may be able to deduct actual expenses. Some taxpayers may qualify to use either the standard mileage rate or actual expenses and, in that case, it may be best to calculate both methods to optimize the deduction and use the most advantageous deduction.

Actual car expenses include:

- Depreciation (explained further in Section 2.8.7)
- Licenses
- Gas
- Oil
- Lease payments

- Insurance
- Garage rent
- Registration fees
- Repairs
- Tires

Other car expenses for parking fees and tolls attributable to business use are separately deductible, whether using the standard mileage rate or actual expenses.

If an automobile has been fully depreciated, taxpayers may continue to deduct other actual expenses while the car or truck is in service.

For more detailed information and stipulations, please reference IRS Publication 463.

To deduct expenses for a car or truck used for a business purpose, taxpayers must prove the expenses. Timely and accurate recordkeeping is required to support any deduction for expenses. Amounts deducted cannot be approximate or estimates. Written evidence is considered the most adequate way to keep records for car and truck expenses.

Written evidence should include the amount of the expenditure, the date of time of use, place or description of the expenditure, and business purpose and relationship. Written evidence should also include a detailed, written, daily mileage log. Generally, documentary evidence such as receipts, cancelled checks, or bills, is required to support deductions.

2.8.3 Business Use of Home (regular vs. simplified method)

Self-employed taxpayers and partners may be able to deduct certain expenses for a part of their home used for business.

To deduct expenses for business use of the home, the taxpayer's home must be used as one of the following:

- Exclusively and regularly as taxpayer's principal place of business for trade or business
- Exclusively and regularly as a place where the taxpayer meets and deals with patients, clients, or customers in the normal course of the trade or business
- A separate structure used exclusively and regularly in connection with a trade or business that is not attached to the taxpayer's home
- On a regular basis for storage of inventory or product samples used in a trade or business of selling products at retail or wholesale
- For rental use
- As a daycare facility

If the part of the taxpayer's home used is a separate structure, qualifying for a home-office deduction for its use requires that the separate structure be used exclusively and regularly in connection with the taxpayer's trade or business. However, the structure does not have to be the taxpayer's principal place of business or where he or she meets patients, clients, or customers. Additional tests apply to an employee's use of part of his or her home for business purposes.

Exclusive Use Requirement

Deductions for expenses for any part of the home that is used for both personal and business purposes are not allowed. The general rule that applies to qualifying for a home-office deduction requires that the taxpayer use a specific area of the home only for trade or business.

Thus, the general rule mandates that the portion of the home used:

- Be a specific area, i.e., a room or other separately identifiable space; and
- Must be used solely in the taxpayer's trade or business.

Despite the requirement for a specific area, the space used need not be marked off by a permanent partition. However, under the general rule requiring exclusive use, a taxpayer will not qualify for a home-office deduction if the area is used for both business and personal purpose.

Example: Patricia's Use Qualifies under Exclusive Use Requirement

Patricia, a partner, engages in the practice of law and uses a room in her home exclusively for writing legal briefs, preparing documents, and meeting with clients. The room is used for no other purpose. Since the room in Patricia's house is a separately identifiable space and is used only in her legal practice, it meets the exclusive use requirement and may qualify for a home-office deduction under the general rule.

Example: Benson's Use Does Not Meet Exclusive Use Requirement

Benson, who is self-employed, uses a room in his home to prepare tax returns for his clients. When he is not using the room to prepare tax returns, he and his wife use it as a place to watch television. Because the room Benson uses as his office is also used for personal purposes by the

family as a TV room, Benson would not qualify for a home-office deduction; the room fails to meet the exclusive use requirement.

Exceptions to Exclusive Use Requirement

Although the general rule requiring exclusive use in a taxpayer's trade or business to take a home-office deduction for business use applies to all other uses, two exceptions to that exclusive use requirement exist. Those exceptions apply to the taxpayer's use of part of the home:

- For the storage of inventory or product samples: or
- As a daycare facility.

Except for these two uses, any part of the taxpayer's home used for business purposes must meet the exclusive use test to qualify for a home office deduction. Let's consider the requirements that apply to each of these uses.

Storage of Inventory or Product Samples

For a taxpayer to be able to deduct expenses for the business use of his or her home for storage of inventory or product samples, without the need to satisfy the general rule requiring exclusive use of the space, the taxpayer (and the space) must meet all the following tests:

- The taxpayer sells products wholesale or retail as a trade or business.
- The taxpayer keeps the inventory or product samples in his or her home for use in the trade or business.
- The taxpayer's home is the only fixed location of his or her trade or business.
- The taxpayer uses the storage space on a regular basis; and

- The space used by the taxpayer is separately identifiable and suitable for storage.

Use as Daycare Facility

The second exception to the exclusive use requirement normally applicable to taking the home office deduction for business use of a taxpayer's home applies to the taxpayer's use of space in the home for providing daycare. For a taxpayer to qualify for the daycare exception to the exclusive use rule, the taxpayer must:

1. Be in the trade or business of providing daycare for

- children
- persons aged 65 or older, or
- persons who are physically or mentally unable to care for themselves; and

2. Have applied for, been granted, or be exempt from having a license, certification, registration, or approval as a daycare center or as a family or group daycare home under state law.

It is important to understand that for a taxpayer to qualify for the home-office deduction as a daycare provider even though the space is not used exclusively for business purposes, the taxpayer must meet both previous requirements. Thus, if the taxpayer's application was rejected or license or other authorization was revoked, the exception to the exclusive use rule does not apply.

Example:

Ana is licensed by the state to operate an adult daycare business. She provides care during daylight hours to people aged 65 or older in a large,

airy room of her home. When the room is not being used for her adult daycare business, it is used by her and other family members as a television and game room. Even though the room Ana uses to conduct her adult daycare business is not used exclusively for the business, she may take a home-office deduction since operation as a daycare facility constitutes an exception to the exclusive use rule applicable to the home-office deduction for business use of a taxpayer's home.

Regular Use Requirement

In addition to the exclusive use requirement applicable to a taxpayer's ability to take a home-office deduction for business use of the home, the taxpayer must also meet the requirements that the space be used:

- For business on a regular basis; and
- In connection with trade or business.

If either of these requirements is not met, no home-office deduction for business use is permitted.

In order for a taxpayer using part of his or her home for business purposes to qualify for a home-office deduction, the specific area of the home used for business must be used on a regular basis. Thus, space in a home that is used for business purposes only on an occasional or irregular basis would not qualify the taxpayer for a home-office deduction. To determine if part of a taxpayer's home is used on a regular basis for business purposes, all facts and circumstances surrounding the business use of the space should be considered.

Although the exclusive use rule and its exceptions are straightforward and simple to apply, the requirement that a taxpayer use the space on a regular basis to qualify for the home-office deduction is far less straightforward.

A taxpayer can rely on two types of information to prove his or her regular use of a home office for purposes of the deduction:

1. A contemporaneous log of time spent in the office; and
2. Documents corroborating time spent in the office, such as:
 - emails sent,
 - a guest log signed by clients, or
 - telephone billing statements indicating the taxpayer made telephone calls from the home office during the times indicated in the log.

A taxpayer may maintain a home office as a place in which to engage in several types of activities. However, those activities may or may not entitle the taxpayer to a home-office deduction. It is important for the taxpayer to qualify for a home-office deduction, that the home office be used in a trade or business. If the office is used for some function other than as a place in which to engage in a trade or business, including engaging in a profit-seeking activity that does not constitute a trade or business, no home-office deduction is permitted.

Example:

Julio retired last year and received a substantial early retirement buyout that he uses for investment purposes. Although he does not operate as a broker or dealer, he spends several hours each day in his home office reading financial periodicals, deciding on various strategies for increasing his wealth, and making trades for his own account. While Julio clearly is engaged in a profit-making activity and uses his home office to further that objective, the fact he is not engaged in a trade or business means that no home-office deduction is permitted.

Principal Place of Business Requirement

As noted earlier, for a taxpayer to be able to take the home-office deduction for business use of a home, the home office normally must be used exclusively and regularly as the taxpayer's principal place of business. We have already looked at the exclusive and regular use requirements and will turn our attention now to the principal place of the business test.

A taxpayer may have more than one business location at which he or she engages in a single trade or business. Despite having multiple locations, however, a taxpayer may still qualify for a home-office deduction. Qualifying to deduct the expenses for the business use of a home under the principal place of business test requires that the taxpayer's home must be the principal place of business for the trade or business.

Making the determination as to whether the taxpayer's home is his or her principal place of business requires consideration of:
--

- The relative importance of the activities performed at each place where the taxpayer conducts business; and
- The amount of time the taxpayer spends at each place where he or she conducts business.

A taxpayer's home office qualifies as his or her principal place of business if the taxpayer:

- Uses the home office exclusively and regularly for administrative or management activities of the trade or business; and
- Has no other fixed location where he or she conducts substantial administrative or management activities of the trade or business.

If the taxpayer's home cannot be identified as the principal place of business after considering the relative importance of the activities performed in it and the amount of time spent there, and the home-office deduction is not otherwise allowed as a place to meet patients, clients, or customers or as a separate structure, no home-office deduction is permitted.

Administrative or Management Activities

Note that a home office may qualify as a taxpayer's principal place of business if it is used for administrative or management activities of the trade or business. But what constitutes administrative or management activities?

When performed in connection with the trade or business, the following functions are examples of administrative or management activities:

- Billing customers, clients, or patients
- Keeping books and records
- Ordering supplies
- Setting appointments
- Forwarding orders or writing reports

Exceptions to Principal Place of Business Rule

In certain limited cases, a home office may qualify for a home-office deduction even though the space used for the home office is not the taxpayer's principal place of business. Those exceptions apply to the following situations:

- Part of the taxpayer's home is used to meet with patients, clients, or customers; or
- The premises are a free-standing, separate structure that is used exclusively and regularly for the taxpayer's business.

IRS Publication 587 outlines the provisions for the home office deduction.

Figuring the Deduction

Taxpayers can use one of two methods to figure their home-office deduction:

- Regular Method (or Actual Expense Method)
- Simplified Option

Taxpayers using the regular method must determine the actual expenses of their home office. Taxpayers who use the regular method base deductions on the percentage of the home used as the office in home. These expenses include items such as real estate taxes, mortgage interest, insurance, utilities, repairs, maintenance, and depreciation.

Regular or Actual Expense Method

The actual expense method of figuring a home-office deduction uses the actual expenses incurred by the taxpayer as the basis for determining the deduction allowable for business use of the taxpayer's home. Bear in mind when using the actual expense method to figure the home-office deduction that a taxpayer cannot deduct expenses for the business use of a home incurred during any part of the year he or she did not use the home for business purposes.

Thus, a taxpayer who begins using part of his or her home for business purposes beginning on July 1st of the year and who qualifies for a home

office deduction cannot consider expenses for the period prior to July 1st. Instead, the taxpayer may consider only those expenses for the period July 1 through December 31 in figuring the allowable deduction.

When using the actual expense method for figuring the home-office deduction for a client, a tax return preparer must determine:

- The nature of the expense; and
- The percentage of homes used for business purposes.

Nature of the Expense

When determining the nature of the taxpayer's expense, expenses are placed into one of the following three categories:

- Direct expenses
- Indirect expenses
- Unrelated expenses

Direct expenses are expenses applicable to and affecting only the business part of the taxpayer's home. Except for daycare facility expenses that may be only partially deductible as discussed later under Daycare Facility, these expenses are deductible in full, subject to any applicable deduction limit. (See Deduction Limit later in this unit.)

Examples of direct expenses that may be deductible in full, subject to the deduction limit, include expenses for:

- Painting
- Making needed repairs
- Cleaning carpets

The above direct expenses are only allowable when incurred in the area used for business purposes.

Indirect expenses are those expenses the taxpayer incurs for keeping up and running his or her entire home. Such indirect expenses are deductible under the home-office deduction in an amount based on the percentage of the taxpayer's home used for business purposes. Like direct expenses, the deduction of indirect expenses is subject to the applicable deduction limit.

Examples of indirect expenses that may be deductible in part, based on the percentage of the home used for business purposes and subject to applicable deduction limits, include expenses for:

- Insurance
- Utilities
- General repairs
- Homeowner association dues

The third category of taxpayer expenses, expenses that are unrelated, are applicable only to the parts of the taxpayer's home that are not used for business purposes. These unrelated expenses are not deductible.

Unrelated expenses incurred by a taxpayer whose business use of a home qualifies for a home-office deduction for direct and allocable indirect expenses include expenses for:

- Lawn maintenance
- Painting of rooms not used for business purposes

Such unrelated expenses are not deductible for purposes of the home office deduction.

Although direct expenses attributable to business purposes are deductible under the home-office deduction irrespective of the percentage of the home used by the taxpayer for business purposes, indirect expenses are not. Instead, indirect expenses are deductible under the home-office deduction only in an amount equal to the total of such indirect expenses multiplied by the percentage of the home used for business.

Suppose a taxpayer's indirect expenses amounted to \$5,000 and 10% of the home was used for business purposes. The amount of the indirect expense attributable to business purposes would then be \$500. ($\$5,000 \times 10\% = \500)

Calculating Percentage of Home Used for Business

A taxpayer is permitted to use any reasonable method to determine the percentage of his or her home used for business purposes. Two methods commonly used for determining the applicable percentage of a home for purposes of the home-office deduction are:

1. Dividing the square footage of the home used for business purposes by the total square footage of the home; and
2. Dividing the number of rooms used for business by the total number of rooms in the taxpayer's home.

Percentage Based on Square Footage

To determine the percentage of a taxpayer's home used for business purposes based on square footage, simply divide the square footage of the space used for business by the square footage of the entire house.

Percentage Based on Number of Rooms

Determining the percentage of a taxpayer's home used for business purposes by dividing the number of rooms used for business by the total number of rooms in the house should be used only if the rooms in the house are all the same size.

To determine the percentage of a taxpayer's home used for business purposes based on the number of rooms in the house compared with the number of rooms used for business purposes produces the same result. To make the calculation requires only that the number of rooms used for business be divided by the total number of rooms in the home.

Deductible Expenses for Home-Office Deduction

Expenses that are deductible under the home-office deduction fall into two categories and include the following:

- Expenses that are deductible by the taxpayer whether the taxpayer uses the home for business purposes, i.e., they are deductible by all homeowners; and
- Expenses that are deductible by the taxpayer only if the taxpayer uses the home for business purposes.

In addition to those expenses that are deductible by all homeowners, many additional expenses are deductible by homeowners who use their homes for business purposes. These are expenses that would not normally be deductible by the homeowner.

Principal among those expenses that are deductible by a homeowner who uses the home for business purposes, in an amount determined by the percentage of the home used for business, are the following:

- Depreciation
- Insurance
- Rent paid for the use of unowned property used in the taxpayer's trade or business
- Repairs
- Security system maintenance and monitoring expenses
- Expenses for utilities and services

Although these expenses are deductible by a taxpayer using his or her home for business purposes, it is important to keep in mind that only the business percentage of these expenses is deductible.

Deduction Limit

The home-office deduction is not unlimited. Instead, if a taxpayer uses the actual expense method for claiming a home-office deduction, the deduction of otherwise nondeductible expenses, expenses such as insurance, utilities, and depreciation allocable to the business, is limited to the taxpayer's gross income from the business use of the home minus the sum of the following:

1. The business portion of expenses the taxpayer could deduct even if he or she did not use the home for business purposes. Such expenses include mortgage interest, real estate taxes, and casualty losses attributable to a federally declared disaster area allowable as itemized deductions on Schedule A (Form 1040 or 1040-SR) or net qualified disaster losses of the taxpayer claims the standard deduction; and
2. The business expenses that relate to the business activity in the home but not to the home itself. Such expenses include the costs of business

telephone, supplies, and equipment depreciation. A self-employed taxpayer should not include in the business expenses that must be subtracted from gross income the one-half of self-employment tax the taxpayer is permitted to deduct.

In applying the deduction limit to a taxpayer's home-office deduction, the depreciation deduction should be taken last. If the taxpayer's home-office deduction in any year is reduced by the deduction limit, the taxpayer may carry over the excess to the next year in which he or she uses the actual expense method in claiming a home-office deduction. The carried over expenses are subject to the deduction limit for the year to which they are carried over, whether the taxpayer lives in the same home during that year.

Simplified Method

Instead of using the actual expense method of determining a taxpayer's home-office deduction, a simplified method, available for years beginning January 1, 2013, may be used. When calculating the home-office deduction using the simplified method, the deduction is equal to the area of the taxpayer's home used for a qualified business use (not exceeding 300 sq. ft.) multiplied by the prescribed rate. The current prescribed rate is \$5, but the IRS and the Treasury Department may update the prescribed rate from time to time.

Election of the simplified method is irrevocable for the year made. The taxpayer's election of whether to use the actual expense method or simplified method is one that is made each year. The election to use the simplified method to figure the home-office deduction must be made on a timely filed, original federal income tax return.

Depreciation and Actual Expenses Related to Use of Home not Deductible

If a taxpayer elects to use the simplified method of determining the home office deduction, neither depreciation nor any actual expenses other than those not related to use of the home, may be deducted. Business expenses not related to the taxpayer's use of the home continue to be deductible.

If a taxpayer used the actual expense method to figure the home-office deduction in a previous year and has an expense carryover because the deduction was limited in that year, no portion of the carried-over amount may be deducted in any year in which the taxpayer uses the simplified method. In such a case, the taxpayer will continue to carry over the disallowed amount to the next year in which he or she uses actual expenses to figure the home-office deduction.

Special Rules Applicable to Simplified Method

Special rules apply to a taxpayer using the simplified method to determine the home-office deduction under certain circumstances. Those special rules are applicable in the case of:

- Shared use of a home
- Multiple qualified business uses
- Multiple homes
- Part year use or area changes

Gross Income Limitation

Somewhat like the deduction limit applicable to the actual expense method for determining the home-office deduction, a gross income limitation applies to the home-office deduction available under the simplified method. Under the gross income limitation applicable to the simplified method, a taxpayer's home-office deduction is limited to an amount equal to the taxpayer's gross income derived from the qualified business use of the home reduced by the business deductions that are unrelated to the use of the taxpayer's home.

Deducting and Recordkeeping

After qualifying for a home-office deduction and determining the deduction amount, a taxpayer must report the deduction on IRS Form 1040 or 1040-SR and retain sufficient evidence for a specified period to support it. In this unit, we will examine the rules related to where the expenses of a home office are deducted and the recordkeeping requirements applicable to taking and supporting such a deduction.

Expenses Deductible Only When Home is Used for Business

While the deductible expenses already discussed are deductible by a taxpayer whether the taxpayer's home is used for business, certain other expenses are deductible only when the taxpayer's home is used for business purposes.

Those expenses that are deductible by a taxpayer using the actual expense method only to the extent related to the business use of the taxpayer's home include:

- Insurance

- Maintenance
- Utilities
- Depreciation of the home

Accordingly, the personal portion of any of these expenses remains nondeductible. If the taxpayer uses the simplified method of determining the home-office deduction, these expenses do not figure into the deduction allowed for business use of the taxpayer's home.

Where the taxpayer using the actual expense method deducts the business portion of the above expenses depends on the method used by the taxpayer to figure the deduction for business use of the home.

Actual Expense Method for the Self-Employed

A taxpayer who files Schedule C and claims a home-office deduction using the actual expense method should report the home expenses that would not be allowable if the home were not used for business on the appropriate lines of Form 8829. If these expenses exceed the deduction limit, the taxpayer should carry over the excess to the next year in which the actual expense method is used, and the carryover will be subject to the following year's deduction limit.

If the taxpayer files Schedule F, the otherwise nondeductible expenses for insurance, maintenance, utilities, depreciation, etc. should be included with the taxpayer's total business use of the home expenses on Schedule F, line 32, and the notation "business use of home" should be entered on the adjacent dotted line.

Irrespective of how the taxpayer figures the home-office deduction, the taxpayer should deduct business expenses that are not for the use of the

taxpayer's home on the appropriate lines of Schedule C or Schedule F in full. Since these expenses are not for the use of the taxpayer's home, they are not subject to the deduction limit for business use of the home expenses.

2.8.4 Record Keeping Requirements for Business Use of Home

Taxpayers are required to keep records that provide information needed to figure the deduction for business use of the taxpayer's home. Thus, a taxpayer should keep canceled checks, receipts, and other evidence of expenses he or she paid. In connection with the home- office deduction, the taxpayer's records must show the following information:

- The part of the taxpayer's home used for business purposes.

- That the taxpayer used part of the home exclusively (unless its use constituted an exception from the exclusive use requirement) and regularly for business as:

- a. The taxpayer's principal place of business, or
- b. The place where the taxpayer meets or deals with clients or customers in the normal course of business.

In addition, the taxpayer must keep records to prove the home's depreciable basis, including records evidencing:

- When and how the taxpayer acquired the home
- The home's original purchase price
- Any improvements made to the home
- Any depreciation the taxpayer is allowed because of maintaining an office in the home

Taxpayers must keep the records required to support their deduction for business use of a home for as long as they are important for any tax law. Accordingly, applicable records should normally be kept until the later of:

- Three years from the tax return due date or the date filed
- Two years after the tax was paid

The simplified option can significantly reduce record keeping burdens for small business owners by allowing taxpayers to apply a prescribed rate by the allowable square footage of the home office instead of deducting the actual expenses. Using the simplified method does not change the criteria for who may claim a home office deduction.

Net Profit or Loss from Schedule C / Schedule SE

Any net profit or loss calculated on Schedule C should be reported on Form 1040, Schedule 1, line 3. These amounts should be included in the gross income.

Schedule SE

Use Schedule SE (Form 1040 or 1040-SR) to figure self-employment tax for the taxpayer. Self-employment tax is comparable to the Social Security and Medicare tax withheld from an employee's wages. For more information about this tax see Publication 334, Tax Guide for Small Business.

NOTE: Statutory employees typically have Social Security and Medicare tax withheld from their earnings and therefore do not need to file a Schedule SE.

Form 1040 or 1040-SR and Schedule SE, Self-Employment Tax, must be filed if either:

- Net earnings from self-employment (excluding church employee income) were \$400 or more
- Church employee income was received for \$108.28 or more

A return must be filed for the self-employed individual when gross income is at least as much as the filing requirement amount for their filing status and age.

Example:

Antonio, a single taxpayer, works part-time as a retail clerk and works for himself as a wedding photographer. In the tax year, he earned \$9,500 (after expenses) for taking wedding photos. Antonio must file Form 1040 or 1040-SR, Schedule C, and Schedule SE.

Example:

Margaret received income as a statutory employee reported on a W-2 for her cosmetic sales, and 1099-NEC for her work maintaining the network at a local attorney's office. When filing her return, include one Schedule C for her IT contracting and one Schedule C for her cosmetic sales. She will also need to file Schedule SE to report Social Security and Medicare tax for her work as an IT contractor.

2.7.4 Schedule C Record Keeping

It is important for self-employed individuals to keep diligent, accurate records. Good recordkeeping can help taxpayers:

- Monitor progress of the business
- Prepare financial statements
- Identify the source of receipts

- Track deductible expenses
- Prepare tax returns
- Support items reported on their tax return

The taxpayer's type of business may determine the type of records kept; however, the recordkeeping system should include a summary of all business transactions. This summary is usually made in the taxpayer's books (accounting journals, ledgers, etc.). Books should show gross income, deductions, and credits.

As part of recordkeeping, it is important that a taxpayer retains support documents such as sales slips, paid bills, invoices, receipts, deposit slips, and canceled checks. Support documents help support entries on the taxpayer's tax return. These documents should be kept in an orderly fashion and in a safe place.

Any record should be kept if it may be necessary for the administration of any provision of the Internal Revenue Code. Taxpayers should keep records that support an item of income or deduction on a tax return until the periods of limitation for the return run out.

The period of limitations is the period in which a taxpayer can amend a return to claim a credit or refund, or the IRS can assess additional tax. Review the table from IRS Publication 583 to see the period of limitations.

See the table below for the Period of Limitations.

If you ...	THEN period es ...
Owe additional tax and situations (2), (30, and (4), below, do not apply to you	3 years
Do no report income that you should report, and it is income than 25% of the gross income show on the return	6 years
File a fraudulent return	Not limited
Do not file a return	Not limited
File a claim for credit or refund after you filed a return	Later 3 years o 2 years after tax was paid
File a claim for a loss from worthless securities or a bad debt deduction	7 years

2.8.5 Entertainment Expenses (50% business meals deductible)

Prior to the TCJA, a taxpayer could deduct expenses for activities considered to be entertainment, amusement, or recreation if the expenses were related or associated with the active conduct of the taxpayer's trade or business. For amounts incurred or paid after December 31, 2017, deductions for entertainment expenses are disallowed.

The TCJA deemed entertainment expenses as nondeductible regardless of the relationship of the expenses to the business activity, including meals purchased during entertainment activities.

There are a few exceptions outlined in Code Sec. 274(e) including:

- Expenses for goods, services, and facilities that are treated as compensation to an employee
- Expenses paid or incurred by the taxpayer in connection with the performance of services for another person, under a reimbursement or other expenses allowance agreement
- Expenses for recreational, social, or similar activities primarily for the benefit of the taxpayer's employees, other than highly compensated employees

Businesses can still deduct 50% of amounts paid for meals associated with the active conduct of the taxpayer's trade or business. For example, employee travel meals are still 50% deductible.

The TCJA did reduce the deduction for meals provided to employees for the convenience of the employer. Only 50% of those expenses are deductible, and after 2025 this deduction will be completely disallowed.

No deduction is allowed for the expense of any food or beverage unless:

- Such expense is not lavish or extravagant under the circumstances; and
- The taxpayer (or an employee of the taxpayer) is present at the furnishing of such food or beverages.

Temporary 100% Deduction for 2021 and 2024

The Consolidated Appropriations Act of 2021 (CAA) provides for a temporary exception to the 50% limitation for business meals provided by a restaurant. Qualified business meal expenses paid or incurred during 2021 and 2024 are 100% deductible.

Restaurants includes businesses that prepare and sell food or beverages to retail customers for immediate consumption, regardless of if the food and beverage is consumed on the premises.

Restaurants do not include businesses that primarily sell pre-packaged food or beverages not meant for immediate consumption, including grocery stores, vending machines or kiosks, specialty food store, drug stores, convenience stores, and liquor stores.

An employer may not treat as a restaurant any eating facility on the business premises issued to provide meals to employees (excluded from income) or a facility treated as a de minimis fringe benefit, even if operated by a third party as a restaurant. The IRS issued Notice 2021-25 to provide guidance for the temporary 100% business meals deduction.

2.8.6 Section 179 Expenses Limits

Taxpayers can elect to recover all or part of the cost of certain qualifying property, up to a limit, by deducting it in the year they place the property in service. This is the section 179 deduction. Taxpayers can elect the section 179 deduction instead of recovering the cost by taking depreciation deductions.

To qualify for the section 179 deduction, property must meet all the following requirements:

- It must be eligible property.
- It must be acquired for business use.
- It must have been acquired by purchase.

Section 179 expenses limits have increased for the tax year 2024. For property placed in service after December 31, 2023, the maximum amount that a taxpayer can expense under Code Section 179 is \$1,220,000. To take advantage of the full deduction, the total cost of the assets placed in the service cannot exceed \$3,050,000. A dollar-for-dollar reduction in the maximum Section 179 deduction limit occurs as the total cost of assets placed in service exceeds \$3,050,000.

Example:

In 2024, Olivia purchased several pieces of equipment for his business. She spent \$4,000,000 on the equipment. Assuming all the equipment qualifies for the Section 179 deduction, Olivia can deduct a maximum of \$270,000 as a Section 179 deduction on his 2024 tax return.

Total Cost of Section 179 Assets placed in service in 2024 – Limitation of total assets placed in service = Reduction in max Section 179 deduction
 $\$ 4,000,000 - \$3,050,000 = \$950,000$ Reduction Amount

Expense Limit – Reduction Amount = Allowable Section 179 deduction
 $\$ 1,220,000 - \$ 950,000 = \$ 270,000$ Allowable Section 179 Deduction

Allowable Section property that qualifies for Section 179 expensing includes:

- tangible,
- personal property

179 deductions

The Act also made some changes in which property qualifies as “Section 179 property”. Under the prior law computer software

- qualified real property (qualified leasehold, restaurant, or retail improvement property)

To qualify for the Section 179 deduction property generally must be purchased for use in active conduct or a trade or business.

Under the TCJA, the definition of qualified real property has broadened to include certain improvements to nonresidential real property including:

- roofs
- heating, ventilation, and air-conditioning property
- fire protection and alarm systems
- security systems

Section 179 has also been amended to allow the expense of personal property used in connection with lodging.

Property such as elevators, escalators, building enlargements, or property attributable to the internal structural framework does not qualify as Section 179 property.

2.8.7 Depreciation

Depreciation is the annual deduction allowed to recover the cost of certain property over its prescribed useful life. For the cost to be depreciated, it is generally required that the asset have a life of more than one year.

For an asset or property to be depreciated it must meet the following requirements:

1. The taxpayer taking the deduction must own the property
2. The property must be used in the taxpayer's trade or business or income-producing activity
3. The property must have determinable useful life
4. The property must be expected to last more than one year

Land is never depreciable. Land does not get used up, wear out, or become obsolete. The cost of land includes the cost of clearing, grading, planting, and landscaping. Although land itself cannot be depreciated, certain land preparation costs, such as landscaping costs, incurred in preparing land for business use, can be depreciated. These costs must be so closely associated with other depreciable property that a life for them can be determined.

Example.

Jaime constructed a new building for use in his business and paid for grading, clearing, seeding, and planting bushes and trees. Some of the bushes and trees were planted right next to the building, while others were planted around the outer border of the lot.

If Jaime replaced the building, he would have to destroy the bushes and trees right next to it. These bushes and trees are associated with the building, so they have a determinable useful life.

Therefore, Jaime can depreciate them. Jaime will add the other land preparation costs to the basis of his land because they have no determinable life and are not able to be depreciated.

2.8.7.1 Bonus Depreciation (including new 60% limit)

The Tax Cuts and Jobs Act allows for a 100% first year deduction for the adjusted basis for qualified property placed in service after September 17, 2017, and before January 1, 2023.

In later years, the first-year bonus depreciation deduction phases down:

- 80% for property placed in service after December 31, 2022, and before January 1, 2024
- 60% for property placed in service after December 31, 2023, and before January 1, 2025
- 40% for property placed in service after December 31, 2024, and before January 1, 2026
- 20% for property placed in service after December 31, 2025, and before January 1, 2027

This additional first-year depreciation deduction is allowed for both new and used property.

For certain aircraft and property with longer production periods, the deduction is allowed one additional year. The 100% deduction is allowed for assets placed in service after September 17, 2017, through December

31, 2023. Each of the dates for the reduction percentage listed above are increased by one year.

First-year bonus depreciation is scheduled to sunset after 2026.

2.8.7.2 Luxury Auto Limits

The TCJA has increased depreciation limits for passenger automobiles, trucks, and vans. For passenger automobiles placed in service after December 31, 2023, the maximum amount of allowable depreciation is:

- \$12,400 for the year placed in service
- \$19,800 for the second year in the recovery period
- \$11,900 for the third year in the recovery period
- \$7,160 for the fourth, fifth, and sixth years in the recovery period

If bonus depreciation is claimed, an additional \$8,000 may be expensed arriving at a maximum first year deduction of \$20,400 in 2024.

2.8.7.3 Listed Property

To avoid misuse of the depreciation deduction for assets that could easily be used for both personal and business use, specific rules and record keeping requirements have been set in place for this “Listed Property.”

Prior to the TCJA, listed property included the following:

- passenger automobiles
- property used for transportation
- property used for entertainment, recreation, or amusement
- computers and related peripheral equipment

The TCJA ended the inclusion of computers and related peripheral equipment as listed property. This change is effective for property placed in service after December 31, 2017.

If business-related use of a listed property is more than 50% in a tax year, the property can be treated the same as any other business asset. But if business-related use is less than 50%, the asset is not considered used in a business, and the ADS straight-line depreciation should be used to count the deduction. This is called the predominant-use test.

Because a listed property needs to pass the predominant use test to decide if it can be treated as other business assets, the user needs to maintain detailed records of the use of the listed property. An example would be a log of the mileage of a vehicle used for business. The record should also include the expenditure related to the asset, such as cost of the property, repairs, insurance, and others.

2.9 Schedule D and Form 8949, overview of capital gains and losses

Assets owned and used by the taxpayer for personal or investment purposes are considered capital assets. Examples would be real estate, stocks, bonds, and cryptocurrency, among other items. When a capital asset is sold or exchanged, the difference between the basis (or investment) and the sales price is the capital gain or capital loss.

Capital gains fall into two categories long-term and short-term.

- a) If an asset was held for more than one year, it is considered long-term.
- b) if held for one year or less, it is considered short-term.

Capital gains may be taxed at a lower rate than ordinary income tax rates. Losses from the sale of personal-use property cannot be deducted;

however, there are some provisions (with limitations) to deduct net capital losses from investment property.

Capital gains and deductible capital losses are reported on Schedule D and on Form 8949. Figure a gain or loss by comparing the amount realized with the adjusted basis of the property.

- a) Gain - If the amount realized from a sale or trade is more than the adjusted basis of the property transferred, the difference is a gain.
- b) If the adjusted basis of the property transferred is more than the amount realized, the difference is a loss.

Adjusted basis - The adjusted basis of property is the original cost or other basis properly adjusted (increased or decreased) for certain items.

Amount realized - The amount realized from the sale or trade of property is everything received for the property minus the expenses of sale. The amount realized includes the money received plus the fair market value of any property or services received.

If property and cash are traded for other property, the amount realized is the fair market value of the property received. Determine the gain or loss by subtracting the cash paid plus the adjusted basis of the property traded in from the amount realized. If the result is a positive number, it is a gain. If the result is a negative number, it is a loss.

Schedule D and Form 8949

Schedule D is used to report gains and losses as the result of the sale or trade of certain property. Form 8949 is used to report the details on each transaction.

Example:

Leo purchased 100 shares of the ABC Company at \$10 a share or \$1,000. Eighteen months after she purchased the stock, the share price increased to \$20 a share and Dionne sold all the stock for \$2,000. She had no expenses in the purchase or sale of the stock. Leo has a long-term capital gain of \$1,000 (\$2,000 sales price - \$1,000 investment). The gain is considered long-term because the stock was held for more than one year.

Schedule D

Use Schedule D for the following purposes.

- To figure the overall gain (or loss) from transactions reported on Form 8949.
- To report a gain from Form 6252 or Part I of Form 4797.
- To report a gain (or loss) from Form 4684, 6781, or 8824.
- To report capital gain distributions not reported directly on Form 1040 or 1040-SR, line 7 (or effectively connected capital gain distributions not reported directly on Form 1040- NR, line 7).
- To report a capital loss carryover from the previous tax year to the current tax year.
- To report your share of a gain (or loss) from a partnership, S corporation, estate, or trust. (However, corporations report this type of gain (or loss) on Form 8949.)
- To report certain transactions, you don't have to report on Form 8949, such as transactions reported to you on a Form 1099-B (or substitute statement) showing basis was reported to the IRS and for

which you have no adjustments, as explained under Exception 1, later.

Individuals, estates, and trusts also use Schedule D to report undistributed long-term capital gains from Form 2439.

Form 8949

A taxpayer uses Form 8949 to list all capital gains and loss transactions and carries the subtotal from this form to Schedule D, where the gain or loss will be calculated in aggregate. Short-term gains are listed together in Part 1, while long-term gains are listed in Part II.

Use Form 8949 to report:

- The sale or exchange of a capital asset not reported on another form or schedule
- Gains from involuntary conversions (other than from casualty or theft) of capital assets not used in a trade or business.
- Nonbusiness bad debts
- Worthlessness of securities
- Election to defer capital gain invested in a Qualified Opportunity Fund (QOF)
- Disposition of interests in QOFs

There are some exceptions as to when Form 8949 is required. Review the instructions for Schedule D and Form 8949 to learn more.

2.10 Standard Deduction

Most taxpayers have a choice of either taking a standard deduction or itemizing their deductions. Usually, taxpayers will choose the method that

gives them a higher deduction. Both the standard deduction and itemized deduction reduce taxable income. The standard deduction is a fixed amount that is usually indexed for inflation each year. The amount of the deduction is based on:

- a) Filing status
- b) Age
- c) Whether or not the taxpayer is blind
- d) Whether or not the taxpayer is a dependent of another

Some individuals are not eligible to take the standard deduction including those who:

1. file their return with the filing status of married filing separately, and his or her spouse itemized deductions
2. file a tax return for a short tax year because of a change in annual accounting period; or
3. are a nonresident alien or dual-status alien during the year

For 2024, the standard deduction amount has been raised for most taxpayers. See the table below for the standard deduction amounts.

Filing Status	Tax Year 2023	Tax Year 2024
Single	\$13,850	\$14,600
Head of Household	\$20,800	\$21,900
Married Filing Jointly	\$27,700	\$29,200
Qualifying Surviving Spouse	\$27,700	\$29,200
Married Filing Separately	\$13,850	\$14,600

The standard deduction amount might be increased for taxpayers who are blind or age 65 or older. Alternatively, taxpayers who file as “dependent of another” will see their standard deduction limited based on earned income.

The additional standard deduction for individuals 65 years or older, or blind, per person, is:

- a) \$1,950 for taxpayers filing Single.
- b) \$1,950 for taxpayers filing Head of Household
- c) \$1,550 for taxpayers filing Married Filing Jointly. Married Filing Separately, or as Qualifying Surviving Spouse

Standard Deduction for Dependents

The standard deduction for individual who may be claimed as a dependent by another taxpayer cannot exceed the greater of:

- \$1,300
- Sum of earned income and \$450 (but not more than the regular standard deduction amount, \$14,600)

Example:

Jean and Kathy, both over age 65, have been married for over 25 years and plan to file their return as married filing jointly for 2024. They will not itemize deductions; therefore, they will deduct the standard deduction on their tax return which is \$32,300 ($\$29,200 + \$1,550 + \$1,550$).

Example:

Betty, age 20, earned \$5,000 employed as a base dispatcher during 2024; however, her parents claimed her as a dependent on their 2024 tax return. Betty will file a 2024 tax return as a dependent of another. Her standard deduction will be \$5,400 (earned income: $\$5,000 + \400).

2.11 Itemized Deductions on Schedule A

Even though most taxpayers are eligible to take the standard deduction, it is more advantageous for some taxpayers to take the total allowable itemized deductions. The allowable itemized deductions are specific and can sometimes be limited. If a taxpayer itemizes their deductions, Schedule A must be filed.

Once the amount of itemized deductions is determined, the amount is carried to Form 1040 or 1040-SR, line 12a, and then subtracted from AGI.

2.11.1 Medical and Dental Expenses Deduction

Qualified medical expenses are deductible on Schedule A when deductions are itemized. Deductible expenses include unreimbursed amounts paid during the tax years for the medical care of the taxpayer, spouse, and dependents.

Medical expenses are the cost of diagnosis, cure, mitigation, treatment, prevention of disease, and the costs for treatments affecting any part or function of the body. They include the costs of equipment, supplies, and diagnostic devices needed for these purposes. Medical expenses also include dental care, and the cost of medical and dental insurance (not paid with pre-tax dollars). Medicare premiums can be included as medical insurance. Long-term care insurance premiums can also be deducted, up to a certain limit.

A detailed list of deductible medical expenses is included in IRS Publication 502.

All taxpayers can deduct amount of medical and dental expenses that exceed 7.5% of adjusted gross income (AGI) on Schedule A, Itemized Deductions.

2.11.2 State and Local Tax (SALT)

Prior to the TCJA, taxpayers were allowed an itemized deduction on Schedule A for state and local taxes (SALT) and foreign taxes with an election to deduct state and local general sales tax instead of state and local income tax.

Under new laws introduced by the TCJA, the total deduction for state and local tax is limited to \$10,000 (\$5,000 for married taxpayers filing separately) for tax years beginning after December 31, 2017, and before

January 1, 2026. Foreign real property tax cannot be deducted other than taxes paid or accrued carrying on a trade or business.

Taxpayers cannot deduct both sales tax and income tax. If electing to deduct sales tax, optional sales tax tables may be used. The sales tax deduction would be calculated using adjusted gross income plus any nontaxable income.

The \$10,000 aggregate SALT limitation rule does not apply to state and local tax paid or accrued in carrying on a trade or business.

2.11.3 Home Mortgage Interest Deduction

Home mortgage interest is deductible, subject to limits. A home mortgage is any loan that is secured by a taxpayer's main home or second home. It includes first and second mortgages, home equity loans and lines of credit, and refinanced mortgages.

Home mortgage interest on loan proceeds used to buy, build, or substantially improve a home are considered qualifying debt.

For qualified loans taken out before December 16, 2017, home mortgage interest deductions are limited to the first \$1,000,000 of debt. Additional rules apply for loans taken out before October 14, 1987.

Limits for the home mortgage interest deduction have been further limited by the TCJA, including interest deductions for home equity loans, home equity lines of credit (HELOC), and second mortgages. Interest deductions on loans taken out after December 15, 2017, are affected.

For tax years 2018 through 2025, the deduction for home mortgage interest is limited to the interest on up to \$750,000 (\$375,000 for married taxpayers filing separately) of acquisition indebtedness. For acquisition

of debt before December 15, 2017, the pre-TCJA \$1,000,000 limit applies for the interest deduction.

The deduction for home equity loan interest has been suspended. In this context, the home equity loan is one that is not incurred to acquire, construct, or substantially improve the home. The elimination of the deduction for the interest on unqualified home equity debt applies regardless of when the home equity debt was acquired.

2.11.4 Charitable Contributions

Taxpayers can take deductions for their contributions to qualified organizations. Under pre-TCJA law, the deduction was limited to a prescribed percentage of the taxpayer's AGI, usually 50% but in some cases 20% and 30% limits applied. The deductible percentage was dependent only upon the type of organization to which the donation was made, whether the contribution was made "to" or merely "for the use of" the donee, and whether the contribution was capital gain property.

Charitable contributions remain deductible as an itemized deduction on Schedule A under the TCJA. The percentage limit for cash contributions to a qualified organization has increased from 50% to 60% for tax years ending after December 31, 2017, and before January 1, 2026.

2.11.4.1 60% AGI for cash contribution

Taxpayers can generally deduct qualified charitable contributions up to 60% of their AGI (without a deduction for any net operating loss carryback) for contributions to 60% charities (formerly known as 50% charities). Some examples of 60% limit organizations are:

- a) Churches or associations of churches
- b) Educational Organizations

- c) Hospitals and certain medical research organizations
- d) Foundations for the benefit of state colleges and universities
- e) Publicly supported organizations the 30% limit applied to the following gifts:
- f) Gifts to all qualified organizations other than 60% limit organizations, including gifts to veterans' organizations, fraternal societies, nonprofit cemeteries, and certain private non-operating foundations
- g) Gifts for the use of any organization
- h) Gifts of capital gain property to a 60% limit organization (only if the FMV of the gift is used, not the cost)

A 20% limit applies to noncash contributions that are for the use of, rather than to, any other qualified organization (except 60% organizations).

NOTE: Charitable contributions can only be claimed in 2024 if itemizing.

Athletic Tickets

The TCJA eliminated the charitable contribution deduction for payments to a college or university in exchange for which the donor receives the right to purchase tickets or seating at athletic events. This change is in effect for contributions made in tax years beginning after December 31, 2017. Prior to the enactment of the TCJA, taxpayers could deduct up to 80% of these amounts as a charitable contribution.

Example:

Justin contributed \$16,000 to the University of Pottery on January 10, 2024, in exchange for the right to buy season tickets for premium box seats for the University's hockey games. Justin cannot deduct any amount of the contribution on his 2024 federal tax return.

If Justin had made the same donation on December 31, 2017, he would have been able to deduct 80% or \$12,800 ($\$16,000 \times 80\%$) on his Schedule A as an itemized deduction.

2.11.4.2 Contemporaneous Written Acknowledgement

For tax year 2017 and beyond, the TCJA repealed the provision that provided an exception to the contemporaneous written acknowledgement (CWA) requirement for certain contributions that were reported on the done organization's return.

No deduction will be allowed for any contribution of \$250 or more unless the donor validates the contribution with a contemporaneous written acknowledgement of the contribution from the done organization. The written acknowledgment must include:

- The amount of any money contributed and a description (but not value) of any property donated.
- Whether the organization did or didn't give the taxpayer any goods or services in return for their contribution. If goods or services were received, a description and estimate of the value must be included.

In figuring whether a gift is \$250 or more, do not combine separate donations. For example, if a taxpayer gave their church \$25 each week for a total of \$1,300, treat each \$25 payment as a separate gift.

2.11.5 Federally declared disaster area casualty loss deduction (including loss deduction for non-itemizers)

The TCJA prescribes that personal casualty and theft losses are only deductible to the extent they are attributable to a federally declared disaster. Each personal casualty and theft loss is reduced by \$100, or \$500

if qualified disaster loss rules apply. The total of all casualties or theft losses is further reduced by 10% for AGI. Use Form 4684 for calculations.

If a taxpayer has personal casualty and theft gain, he or she may deduct losses without regard to the federally declared disaster area to the extent of the gain.

If a taxpayer is not itemizing deductions and has a qualified net disaster loss, he or she may be able to deduct an increased standard deduction.

2.11.6 Moving Expenses deduction suspended and reimbursement taxable (except for active military)

In recent years, work-related moving expenses were deductible from gross income if certain tests were met. Beginning January 1, 2018, the deduction for moving expenses has been suspended except for certain members of the military.

The TCJA also amended the income exclusion for qualified moving expense reimbursements. For tax year 2018 and beyond, most taxpayers cannot exclude reimbursed moving expenses from income.

Active-duty members of the U.S. Armed Forces who move pursuant to a military order and incident to a permanent change of station can still deduct moving expenses and exclude reimbursed moving expenses from income. Use Form 3903 and carry eligible amounts to Schedule 1, line 14.

2.11.7 Record Keeping and Documentation for deductions

Keeping accurate and well-organized records is a vital component of tax return preparation. Accurate records and documentation can help substantiate items of income, deductions, and credits if a tax return is selected for review or the taxpayer receives an IRS notice.

Taxpayers must keep records that support an item of income, a deduction, or a credit if they are material in the administration of any provision of the Internal Revenue Code.

Generally, records should be retained until the period of limitations expire for the return. The limit is normally the later of three years from the filing date of the return, or the due date, whichever is later.

It is especially important to keep records for deductions on Schedule A, including documentation for:

- Cash and noncash contributions
- Deductible medical expenses
- Deductible taxes
- Deductible interest paid and underlying loan limit calculations
- Deductible casualty and theft losses

2.12 Tax Credit Eligibility (child tax credit, credit for other dependents, child and dependent care tax credit, education tax credits, earned income tax credit)

Taxpayers might be eligible to take certain credits to reduce tax liability. Credits provide a dollar-for-dollar reduction in taxes owed. Most credits are limited to tax liability and are not refundable, but some credits, such as the Earned Income Tax Credit, are refundable. Refundable credits are not limited to the tax liability and can create a tax refund.

Nonrefundable tax credits include:

- Child and Dependent Care Credit
- Education Credits (American Opportunity Credit is also partly refundable)
- Credit for Elderly or Disabled
- Child Tax Credit
- Foreign Income Tax Credit
- Retirement Savings Contribution Credit
- Adoption Credit Refundable credits include:
- Earned Income Tax Credit
- Excess Social Security Credit
- Additional Child Tax Credit
- Premium Tax Credit
- American Opportunity Credit (partially refundable)

Earned Income Tax Credit

The Earned Income Tax Credit (EITC) is a refundable credit that reduces or eliminates the taxes paid by low-income workers. To claim the credit, the taxpayers must have earned income of less than \$63,398 during the year.

To claim the credit, the taxpayers must file a tax return even if they are not required to file or do not owe any tax and they meet all the rules for taking the credits.

There are four parts for the rules for EITC:

- Rules for Everyone
- Rules for Taxpayers with Qualifying Child(ren)
- Rules for Taxpayers with no Qualifying Child(ren)
- Figuring and Claiming EITC

If the taxpayers have a qualifying child, rules in parts 1, 2, and 4 apply. If the taxpayers do not have a qualifying child, rules in parts 1, 3, and 4 apply.

Earned Income Credit – Rules for Everyone Part 1 - Rules for Everyone

There are seven rules that must be met by everyone who claims the Earned Income Tax Credit for 2024.

Rule 1 – Taxpayers AGI must be less than:

- \$59,899 (\$66,189 for Married Filing Jointly) with three or more qualifying children
- \$55,768 (\$62,688 for Married Filing Jointly) with two or more qualifying children
- \$49,084 (\$56,004 for Married Filing Jointly) with one qualifying child
- \$18,591 (\$25,511 for Married Filing Jointly) with no qualifying child

Rule 2 - Taxpayers must have a valid Social Security Number (SSN).

A taxpayer (and spouse if filing a joint return) must have a valid SSN. Taxpayers with Individual Taxpayer Identification Numbers (ITINs) are not eligible for EITC. The Social Security card must not read “Not Valid for Employment.” Any qualifying child on the return must have a valid SSN, unless the child was born and died during the tax year.

Rule 3 – Filing status generally cannot be married filing separately; however, the American Rescue Plan Act (ARPA) states that married individuals can be treated as unmarried if:

- A MFJ return is not filed
- Qualifying child lived with taxpayer for more than half of the year
- Taxpayer did not live with their spouse the last month of the year or has a decree, instrument, or agreement (other than divorce decree) and is not a member of the same household at the end of the year

Rule 4 – Taxpayers must be U.S. citizens or resident aliens all year.

Rule 5 – Taxpayers cannot file Form 2555 or Form 2555-EZ.

Rule 6 – Investment income must be \$11,000 or less. The ARPA raised the investment income limitation from \$3,650 to \$10,000 for tax years after December 31,2020. The amount is adjusted for inflation in the years after 2021.

For most taxpayers, investment income is the sum of taxable and tax-exempt interest, dividend income, and capital gain net income. If taxpayers file Schedule E, Form 4797, Form 8814, or report income on Schedule 1, line 8, for rental of personal property, review IRS Publication 596.

Rule 7 – Taxpayer (or spouse if Married Filing Jointly) must have earned income. Earned income includes:

- Wages, salaries, and tips
- Taxable employee compensation
- Net earnings from self-employment
- Certain disability pays reported as wages
- Union strike benefits
- Combat pays (if elected to include nontaxable combat pay in taxable income)

- Unearned income includes:
- Unemployment benefits
 - Worker’s Compensation
 - Social Security benefits
 - Retirement income
 - Interest income
 - Payments from public assistance programs
 - Gambling winnings
 - Child Support
 - Alimony
 - Nontaxable foster care payments

Part 2: Rules for Taxpayers with Qualifying Children

Taxpayers with qualifying children not only must meet all the rules in Part 1 – Rules for Everyone but must also meet all the rules in Part 2 – Rules for Taxpayers with Qualifying Children. Rules in Part 4 – Figuring and Claiming EITC also apply.

Rule 8 – Qualifying children must meet relationship, age, residency, and joint return tests. Relationship Test

To be a qualifying child, the child must be the taxpayer's:

- Son, daughter, stepchild, foster child, or a descendent of any of them
- Brother, sister, half-brother, half-sister, stepbrother, stepsister, or descendent of any of them

Age Test

The child must be:

- Under age 19 at the end of 2024 and younger than the taxpayer (or spouse if filing a joint return)
- Under age 24 at the end of 2024, a student, and younger than the taxpayer (or spouse if filing a joint return)
- Permanently and totally disabled at any time during 2024, regardless of age

Residency Test

The child must have lived with the taxpayer in the United States for more than half the year. A child who was born or died during the year is considered to have lived with the taxpayer more than half the year if the

taxpayer's home was the main home more than half the time, he or she was alive in the year.

Joint Return Test

To meet this test, the child cannot file a joint tax return for the year unless the child and his or her spouse file a joint return only to claim a refund.

Rule 9 – The qualifying child cannot be used by more than one person to claim EITC.

Even if a child meets the tests to be a qualifying child of more than one taxpayer, the child can be used as the qualifying child for EITC on only one tax return. Tiebreaker rules apply if more than one taxpayer may use the child as a qualifying child for EITC. Special rules also apply for children of divorced or separated parents. See Publication 596 for an explanation of the tiebreaker and special rules.

Rule 10 – Taxpayer cannot be the qualifying child of another taxpayer.

NOTE: If a taxpayer does not have any qualifying children but meets all the requirements in Part 1 – Rules for Everyone, he or she must also meet the rules in Part 3 – Rules for Taxpayers without Qualifying Children. Rules 11-14 must be met for these taxpayers.

Part 3: Rules for Taxpayers without Qualifying Children

Rule 11 – Taxpayer must be at least age 25 but underage 65.

Rule 12 – Taxpayer cannot be dependent on another person.

Rule 13 – Taxpayer cannot be the qualifying child of another taxpayer.

Rule 14 – Taxpayer must have lived in the U.S. more than half of the year.

The taxpayer (and spouse if filing a joint return) must have been in the United States more than half of the year. Military personnel stationed outside the U.S. on active duty are considered to have lived in the U.S during the duty period for EITC purposes.

Part 4: Figuring and Claiming the EITC

If a taxpayer has met all the requirements in Part 1 – Rules for Everyone and Part 2 – Rules for Taxpayers with Qualifying Children, or Part 3 – Rules for Taxpayers without Qualifying Children, proceed to Part 4 – Figuring and Claiming EITC. Rules in this part must be met by anyone claiming EITC.

Rule 15 – Earned income must be less than certain limits. The earned income on the tax return must be less than:

- \$59,899 (\$66,189 for Married Filing Jointly) with three or more qualifying children
- \$55,768 (\$62,688 for Married Filing Jointly) with two or more qualifying children
- \$49,084 (\$56,004 for Married Filing Jointly) with one qualifying child
- \$18,591 (\$25,511 for Married Filing Jointly) with no qualifying child

Figure EITC using the EIC worksheet. Schedule EIC must also be completed and filed with the tax return to claim the EITC if the taxpayer has a qualifying child.

The maximum credit for tax year 2024 is:

- \$7,830 with three or more qualifying children
- \$6,960 with two qualifying children
- \$34.213 with one qualifying child
- \$632 with no qualifying child

Paid Preparer's Checklist

Paid tax return preparers must complete Form 8867, and it must also be submitted with the returns claiming EITC prepared by a paid tax preparer. Form 8867 ensures that paid preparers consider all EITC requirements and encourage proper EITC due diligence. Preparers should complete the Paid Preparer's Checklist using information provided by the taxpayers. Tax return preparers should be able to explain the meaning and reasoning for each question presented on the checklist.

Preparers are required to:

- Complete Form 8867 after obtaining information from taxpayer(s) and document additional questions asked and the answers given by the taxpayer at the time of the interview
- Submit Form 8867 electronically for every electronic return with EITC
- Attach Form 8867 to any return claiming EITC prepared and presented to the taxpayer for filing
- Provide a copy of Form 8867 to the preparer submitting the tax return if the preparer is not the preparer submitting the return to the IRS

Child Tax Credit

For tax year 2024, the Child Tax Credit (CTC) could be worth up to \$2,000 per qualifying child less than 17 years old.

Qualifying Children

For the Child Tax Credit, a qualifying child is a child, descendant, foster child, stepchild, sibling, stepsibling, or a descendant of any of these, and all the following must be true:

- The child is a U.S. citizen, U.S. national, or resident alien
- The child is under the age of 17 at the end of the tax year
- The child provided less than half of his or her own support in the current tax year
- The child lived with the taxpayer more than half of the current tax year

A child is considered to have lived with the taxpayer if the child was born or died in the current tax year and lived in the home the entire time, he or she was alive. Temporary absences, including school, vacation, medical care, military service, or detention in a juvenile facility, count as time lived in the home.

No CTC is allowed for a taxpayer for any qualifying child unless the taxpayer provides the Social Security Number (SSN) of the child on his or her tax return. The SSN of the qualifying child must be provided to receive both the refundable and non-refundable portions of the child tax credit. Partial credit may be allowed for dependents who are not qualifying children.

Example:

Sara's son, Franklin, turned 17 on December 1, 2024. He is a citizen of the United States and Sara claimed him as a dependent on her return. Franklin is not a qualifying child for the Child Tax Credit because he was not under age 17 at the end of 2024.

No CTC is allowed for a taxpayer for any qualifying child unless the taxpayer provides the Social Security Number (SSN) of the child on his or her tax return. The SSN of the qualifying child must be provided to receive both the refundable and non-refundable portions of the child tax credit. Partial credit may be allowed for dependents who are not qualifying children.

Credit Amount

The maximum amount that can be claimed for the credit is \$2,000 for each qualifying child under age 17.

The credit is partially refundable, up to \$1,700 per qualifying child, for some lower-income taxpayers. Those taxpayers must have at least \$2,500 of earned income.

The income phaseout applies the base amount of \$3,000 per qualifying child and is reduced for taxpayer whose MAGI exceeds:

- \$400,000 married filing jointly
- \$200,000 all other filing statuses

Partial Credit for Other Dependents

In 2024, taxpayers with qualifying dependents other than qualifying children could receive a \$500 non-refundable credit for each qualifying dependent. This is known as the credit for other dependents or ODC.

For purposes of the CTC, MAGI is the AGI plus the following amounts that may apply to the taxpayer:

- Any amount excluded from income because of the exclusion of income from Puerto Rico. On the dotted line next to Form 1040 or 1040SR, line 1, enter the amount excluded and identify it as “EPRI.” Also attach to the return a copy of any Form(s) 499R- 2/ W-2PR
- Any amount on line 45 or line 50 of Form 2555, Foreign Earned Income
- Any amount on line 15 of Form 4563, Exclusion of Income for Bona Fide Residents of American Samoa

If the taxpayer does not have any of the above, then modified AGI is the same as AGI. Child and Dependent Care Credit

The Child and Dependent Care Credit is a nonrefundable tax credit based on expenses incurred for the care of a qualifying person. This care must make it possible for the taxpayer to work or seek employment and is based on a percentage of the amount actually paid for care expenses.

A taxpayer may be able to take the credit for child and dependent care expenses if the taxpayer paid someone to care for:

- The taxpayer’s qualifying child under age 13 whom the taxpayer claims as a dependent
- The taxpayer’s disabled spouse or any other disabled person who could not care for themselves
- The taxpayer’s child who was not claimed as a dependent due to the rules for children of divorced or separated parents

In 2024, the credit can be up to 35% of the taxpayer's expenses. Expenses up to \$3,000 for one child/dependent, or up to \$6,000 for more than one. To qualify, the taxpayer must pay these expenses so he or she (and spouse if married) can work or look for work.

Tests

To claim the credit for child and dependent care expenses, Form 1040 or 1040-SR must be filed, and the following tests must be met:

- Qualifying Person Test
- Earned Income Test
- Work-Related Expense Test
- Joint Return Test
- Provider Identification Test

Qualifying Persons

Child and dependent care expenses must be for the care of one or more qualifying persons. A qualifying person is:

- A qualifying child who is a dependent of the taxpayer and was under age 13 when the care was provided
- The taxpayer's spouse who was not physically or mentally able to care for himself or herself and lived with the taxpayer for more than half the year
- A person who was not physically or mentally able to care for himself or herself, lived with the taxpayer for more than half the year, and either:

Was the taxpayer's dependent?

Would have been the taxpayer's dependent except that:

- He or she received gross income over the limit
- He or she filed a joint return
- The taxpayer, or spouse if filing jointly, could be claimed as a dependent on someone else's return

Earned Income

To claim the credit, the taxpayer (and spouse if filing jointly) must have earned income during the year.

Earned income includes wages, salaries, tips, other taxable employee compensation, and net earnings from self-employment. A net loss from self-employment reduces earned income.

Earned income also includes strike benefits and any disability pay reported as wages.

Generally, only taxable compensation is included, but nontaxable combat pay can be included in earned income if elected by the taxpayer. If filing a joint return and both the taxpayer and spouse received nontaxable combat pay, each may make his or her own election.

Earned income does not include:
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- Pensions and annuities
- Social Security and railroad retirement benefits
- Workers' compensation
- Interest and dividends

- Unemployment compensation
- Scholarship or fellowship grants, except for those reported on a Form W-2 and paid to the taxpayer for teaching or other services
- Nontaxable workfare payments
- Child support payments received
- Income of nonresident aliens which is not effectively connected with a U.S. trade or business
- Any amount received for work while an inmate in a penal institution

Work-Related Expenses

Child and dependent care expenses must be work-related to qualify for the credit. Expenses are considered work-related only if both of the following are true:

- They allow the taxpayer (and spouse if filing jointly) to work or look for work
- They are for a qualifying person's care

Working or Looking for Work

To be work-related, the expenses must allow the taxpayer to work or look for work. If married, generally both the taxpayer and spouse must work or look for work. A spouse is treated as working during any month he or she is a full-time student or is not physically or mentally able to care for him or herself.

Work can be for others or in the taxpayer's own business or partnership. It can be either full- time or part-time. Work also includes actively looking

for work. If, however, the taxpayer does not find a job and has no earned income for the year, this credit cannot be taken.

An expense is not considered work-related merely because it was incurred while working. The purpose of the expense must be to allow the taxpayer to work.

Joint Return Test

Generally, married couples must file a joint return to take the credit. If, however, the taxpayer is legally separated or living apart from his or her spouse, the taxpayer might be able to file a separate return and still take the credit.

Only the custodial parent can claim the credit. A married taxpayer living apart from a spouse is not considered married, and he/she can take the credit if all the following apply:

- Taxpayer files a separate return
- Taxpayer's home is the home of a qualifying person for more than half the year
- Taxpayer paid more than half of the cost of keeping up a home for the year
- Spouse did not live in the taxpayer's home for the last six months of the year

Provider Identification Test

Identify all persons or organizations that provided care for the child or dependent. Use Form 2441, Part I to show the information.

To identify the care provider, give the provider's:

- Name
- Address
- Taxpayer identification number

If the care provider is an individual, the taxpayer identification number is his or her Social Security Number or Individual Taxpayer Identification Number (ITIN). If the care provider is an organization, then it is the Employer Identification Number (EIN).

It is not necessary to show the taxpayer identification number if the care provider is a tax- exempt organization (such as a church or school). In this case, enter “Tax-Exempt” in the space where the tax form calls for the number.

Figuring the Credit

The credit is a percentage of work-related expenses. Expenses are subject to the earned income limit and the dollar limit. The percentage is based on adjusted gross income.

Work-related expenses include only payments made during the tax year.

Earned Income Limit

The amount of work-related expenses used to figure the credit cannot be more than either:

- The taxpayer’s earned income for the year if single at the end of the year
- The smaller of the taxpayer’s or spouse’s earned income for the year if married at the end of the year

NOTE: A spouse who is a full-time student or incapable of self-care is treated as having earned income of at least \$250/month if there is one qualifying person in the taxpayer's home or at least \$500/month for two or more qualifying persons.

Dollar Limit

There is a dollar limit on the amount of work-related expenses that can be used to figure the credit. The dollar limit is a yearly limit. The amount of the dollar limit remains the same no matter how long, during the year, the taxpayer has a qualifying person in their household.

The dollar limits are:

- \$3,000 if work-related expenses were paid for the care of one qualifying person at any time during the year
- \$6,000 if work-related expenses were paid for the care of more than one qualifying person at any time during the year

If work-related expenses were paid for the care of two or more qualifying persons, the \$6,000 limit does not need to be divided equally among them.

To determine the amount of the credit, multiply work-related expenses (after applying the earned income and dollar limits) by a percentage. This percentage depends on the taxpayer's adjusted gross income.

Education Credits

There are two tax credits available to taxpayers who pay expenses for higher (postsecondary) education. They are:

- The American Opportunity Credit
- The Lifetime Learning Credit

Note: For each student, a taxpayer can claim either the American Opportunity Credit, or the Lifetime Learning Credit. This means that only one of the tax breaks can be taken for the same person on the same return.

Parents claiming two or more college-age students as dependents on their return can claim one of these tax breaks for one student and another for a different student.

Taxpayers can still take the student loan interest deduction even if they're claiming one of the other tax breaks.

Expenses paid or deemed paid by a dependent are considered paid by the taxpayer. Someone other than the taxpayer, spouse, or dependent (such as a relative or former spouse) may make a payment directly to an eligible educational institution to pay for an eligible student's qualified education expenses. In this case, the student should be treated as receiving payment from the other person and, in turn, paying the institution. If the taxpayer claims an exemption on his or her tax return for the student, he or she is considered to have paid the expenses.

For purposes of the education credits, consider only qualified education expenses in determining the credit amount. Qualified education expenses must be required for enrollment or attendance at an eligible educational institution and include tuition and required enrollment fees. Expenses include amounts paid to the institution for course-related books, supplies, and equipment.

Only certain expenses for course-related books, supplies, and equipment qualify:

American Opportunity credit. Qualified education expenses include amounts spent on books, supplies, and equipment needed for a course of

study, whether the taxpayer purchases materials from the educational institution as a condition of enrollment or attendance.

Lifetime Learning credit. Qualified education expenses include only amounts for books, supplies, and equipment required to be paid to the institution as a condition of enrollment or attendance. Qualified education expenses do not include amounts paid for:

1. Room and board, insurance, medical expenses, transportation, or other similar personal, living, or family expenses.
2. Any course or other education involving sports, games, or hobbies, or any noncredit course, unless such course or other education is part of the student's degree program or (for the Lifetime Learning credit only) helps the student acquire or improve job skills.
3. Nonacademic fees, such as student activity fees, athletic fees, insurance expenses, or other expenses unrelated to the academic course of instruction.

American Opportunity Credit

This credit is for students who are earning their undergraduate degrees. The credit is specifically limited to those expenses incurred in the first four years of college.

The American Opportunity Credit is an amount equal to 100% of qualified tuition and related expenses up to \$2,000 plus 25% of those expenses more than \$2,000, but not in excess of \$4,000. The maximum credit allowed for tax year 2024 is \$2,500.

The full credit is available to taxpayers with a MAGI of \$80,000 or less (\$160,000 or less if filing jointly). The amount of the credit is gradually

reduced if the taxpayer's MAGI is between \$80,000 and \$90,000 (\$160,000 and \$180,000 if filing jointly). If the MAGI is above \$90,000 (\$180,000 if filing jointly) the taxpayer cannot take the credit.

Up to 40% of the credit (up to \$1,000) is refundable, up to certain income limits.

Lifetime Learning Credit

Where the American Opportunity Credit is limited to the first four years of college, the Lifetime Learning Credit has a wider availability. This credit can be used for graduate school, undergraduate expenses, even professional or vocational courses. Basically tuition, fees and course materials are eligible expenses. There is no limit to how many years it can be claimed for each student.

The credit is 20% of the first \$10,000 of qualified education expenses paid for all eligible students. This credit is nonrefundable, and the maximum credit is \$2,000 per return, regardless of the number of eligible students.

Adoption Credit

Taxpayers may be able to take credit for qualified expenses paid to adopt an eligible child. For 2024, the maximum adoption credit is \$16,810 per child. The adoption credit is nonrefundable, and most taxpayers can claim the credit in the year the adoption is final; however, there are some allowable exceptions and requirements. The credit is calculated on Form 8839 Qualified Adoption Expenses.

Unused credits can be carried forward up to 5 years, or until fully used, whichever comes first. The adoption credit is not refundable.

The amount of the Adoption Credit begins to phase out when 2024 modified adjusted gross income (MAGI) reaches \$252,100 and is eliminated at \$292,150.

Qualifying adoption expenses include expenses that are reasonable and necessary to adopt the eligible child, including:

- Adoption fees
- Court costs
- Attorney fees
- Travel expenses while away from home

Re-adoption expenses related to adoption of a foreign child

For the adoption of a special-needs child, the maximum credit is available regardless of actual qualifying expenses.

For the adoption credit, an eligible child is:

- Any child under age 18. If the child turned 18 during the year, the child is considered eligible for the part of year they were under age 18
- Any physically or mentally disabled person unable to care for himself or herself Retirement Contribution Credit

2.13 Energy credits (Energy Efficient Home Improvement Credit, Residential Clean Energy Property Credit)

The Inflation Reduction Act Modified Section 25C credit after 12/31/2022.

The new law renames the nonbusiness Energy Property Credit as the “Energy Efficient Home Improvement Credit,” and extends the credit

through the end of the 2032 tax year. Amendments made to IRC section 25C apply to property placed in service after December 31, 2022 (with the exception of certain identification number requirements that do not apply until after 2024).

The new law modifies the credit to equal 30% of the sum of:

1. The amount paid or incurred by the taxpayer for qualified energy efficiency improvements installed during the year,
2. The amount of the residential energy property expenditures paid or incurred by the taxpayer during the year, and
3. The amount paid or incurred by the taxpayer during the year for home energy audits.

The lifetime limitation under the old rules is replaced with the following annual limitations:

1. \$1,200 for energy property costs, as well as certain energy efficient home improvements. There are lower limits on doors (\$250 per door and \$500 total), windows (\$600), and home energy audits (\$150)
2. \$2,000 per year for qualified heat pumps, biomass stoves, and biomass boilers

The new law changes the term “residential energy property expenditures” to include any dwelling unit used as a residence by the taxpayer, replacing the “principal residence” requirement that previously applied. The home must be in the United States.

Expenditures include the cost for labor for onsite preparation, assembly, and installation.

To claim credits for products placed in service after 2024, the taxpayer must include on his or her tax return the qualified product identification number of the energy efficient property. A qualified product identification number is a number assigned by a qualified manufacturer to the energy efficient property in which the credit is claimed.

2.14 Clean vehicle credits (IRC 30D(g), 25E(f), and (Rev. Proc. 2023-33))

The Inflation Reduction Act modified Section 25E and Section 30D after 12/31/2022.

The IRA changes the name of the credit from “New Qualified Plug-In Electric Drive Motor Vehicle Credit” to “Clean Vehicle Credit.”

Effective for vehicles placed in service after December 31, 2022, the new law in general modifies the credit amounts and qualifying requirements, with the exception of the new final assembly requirements that apply to vehicles sold after August 16, 2022, the new per vehicle dollar limitation that applies to vehicles placed in service after the IRS issues guidance on the new rules, and the transition rules that allow certain taxpayers to elect to treat their vehicles purchased in 2022 as placed in service before August 16, 2022.

The new law eliminates the phase-out rules when a manufacturer reaches its 200,000th sale and replaces it with an expiration of the credit for all vehicles placed in service after December 31, 2032.

Under the new law, the maximum \$7,500 credit still applies, but is broken into two components.

- A \$3,750 credit when the vehicle satisfies the critical minerals requirement, plus

- A \$3,750 credit when the vehicle satisfies the battery components requirement.

See new IRC section 30D(e) for details on the critical mineral and battery component requirements. The IRS is directed to issue new regulations or guidance on the application of these new requirements.

The new law requires the car dealership who sells the vehicle to the taxpayer to furnish a report to the taxpayer and the IRS that contains:

- The name and taxpayer identification number of the taxpayer,
- The vehicle identification number of the vehicle,
- The battery capacity of the vehicle,
- Verification that original use of the vehicle commences with the taxpayer, and
- The maximum credit allowable to the taxpayer with respect to the vehicle.

The new law requires the final assembly of the vehicle to occur within North America.

Final assembly means the process by which a manufacturer produces a new clean vehicle at, or through the use of, a plant, factory, or other place from which the vehicle is delivered to a dealer or importer with all component parts necessary for the mechanical operation of the vehicle included with the vehicle, whether or not the component parts are permanently installed in or on the vehicle.

The new clean vehicle credit under IRC section 30D applies to newly qualified fuel cell motor vehicles as defined under IRC section 30B. No double tax benefit is allowed.

The new law places a one credit per vehicle limit, determined by the vehicle identification number of the vehicle. The taxpayer must include the vehicle identification number of the vehicle on the tax return to claim the credit.

There is a new modified adjusted gross income limitation that applies. No credit is allowed if the taxpayer's modified AGI for the tax year and the preceding tax year both exceed:

- \$300,000 for MFJ or QSS.
- \$225,000 for HOH.
- \$150,000 for Single or MFS.

There is a new manufacturer's suggested retail price limitation. No credit is allowed if the manufacturer's suggested retail price exceeds:

- \$80,000 in the case of a van,
- \$80,000 in the case of a sport utility vehicle,
- \$80,000 in the case of a pickup truck, and
- \$55,000 in the case of any other vehicle.

The new law eliminates the special rules for 2- and 3-wheeled plug-in electric vehicles under old IRC section 30D(g).

2.15 Overview Topics

2.15.1 Tax Treatment of the acquisition and disposition of digital assets (Notice 2023-34)

Digital assets are any digital representations of value that are recorded on a cryptographically secured distributed ledger or any similar technology. For example, digital assets include non-fungible tokens (NFTs) and virtual currencies, such as cryptocurrencies and stablecoins. If a particular asset has the characteristics of a digital asset, it will be treated as a digital asset for federal income tax purposes.

On Forms 1040 and 1040-SR there is a question about the buying and selling and otherwise acquiring and disposing of digital assets. As of 2022, the “Yes” box should be checked if the taxpayer, at any time during the tax year, (a) received (as a reward, award, or payment for property or services); or (b) sold, exchanged, gifted, or otherwise disposed of a digital asset (or any financial interest in any digital asset). “Yes” should be checked as of 2022 if at any time during the year, the taxpayer:

- Received digital assets as payment for property or services provided.
- Received digital assets because of a reward or award.
- Received new digital assets because of mining, staking, and similar activities.
- Received digital assets because of a hard fork.
- Disposed of digital assets in exchange for property or services.
- Disposed of a digital asset in exchange or trade for another digital asset.
- Sold a digital asset.

- Transferred digital assets for free (without receiving any consideration) as a bona fide gift; or
- Otherwise disposed of any other financial interest in a digital asset.

A taxpayer has a financial interest in a digital asset if one is the owner of record of a digital asset or has an ownership stake in an account that holds one or more digital assets, including the rights and obligations to acquire a financial interest, or one owns a wallet that holds digital assets.

The following actions or transactions, alone, generally don't require a "Yes" answer:

- Holding a digital asset in a wallet or account.
- Transferring a digital asset from one wallet or account one owns or controls to

another wallet or account that one owns or controls; or

- Purchasing digital assets using U.S. or other real currency, including through the use of electronic platforms such as PayPal and Venmo.

If taxpayers dispose of digital assets during the year that was held as a capital asset, capital gains or losses should be calculated on Form 8949. If taxpayers receive digital assets as compensation for services or dispose of digital assets that were held for sale in a trade or business, it should be reported on the tax return on the applicable form, such as Schedule C.

Any income or gain of digital assets should be reported the same way taxpayers would report any other type of income.

IRS Notice 2014-21 states that virtual currency is treated as property for the purposes of federal income tax. General tax principles applicable to

property transactions apply to transactions using virtual currency. Notice 2014-21 provides examples and frequently asked questions.

Revenue Ruling 2019-24 addresses two issues with hard forks of virtual currency:

1. A taxpayer does not have gross income under § 61 of the Internal Revenue Code (Code) as a result of a hard fork of a cryptocurrency the taxpayer owns if the taxpayer does not receive units of a new cryptocurrency.
2. A taxpayer does have gross income under § 61 as a result of an airdrop of a new cryptocurrency following a hard fork if the taxpayer receives units of new cryptocurrency.

2.15.2 Alternative Minimum Tax (AMT) – exemption/phaseout amounts

The TCJA increased the alternative minimum tax (AMT) exemption amounts and raised the phaseout thresholds for exemptions. AMT exemptions are also permanently indexed for inflation.

For tax year 2024, the statutory exemption amounts are:

- \$85,700 single or head of household
- \$133,300 married filing jointly or Qualifying Surviving Spouse
- \$66,650 married filing separately
- \$29,900 estates and trusts

The above AMT exemptions are reduced by 25% of the amount by which the taxpayer's Alternative Minimum Taxable Income (AMTI) exceeds certain phaseouts. The AMT exemption amount cannot be reduced below zero.

Phaseout amounts are:

- \$1,218,700 married filing jointly or Qualifying Surviving Spouse
- \$609,350 all other taxpayers

The AMT exemption completely phases out at:

- * \$952,150 single or head of household
- * \$1,751,900 married filing jointly or qualifying surviving spouse
- * \$875,950 married filing separately

2.15.3 Qualified Business Income Deduction (QBI) (including Form 8994 and Form 8995-A)

The TCJA introduced a new deduction for noncorporate taxpayers for qualified business income (QBI). This new deduction is sometimes called the “Section 199A” deduction. It is effective for tax years beginning after December 31, 2017.

Under the new law, taxpayers are generally entitled to take a deduction of 20% of qualified business income earned from:

- sole proprietorships reported on Schedule C
- some trusts and estates
- S corporation or partnership
- Qualified rental real estate activity

QBI is defined as the net number of items of income, gain, deduction, and loss with respect to the trade or business. Certain type of income regarded as investment-related are excluded from QBI, including:

- capital gains or losses

- dividends
- interest income
- employee compensation
- guaranteed payments to a partner

The QBI deduction is usually limited to the lesser of:

- 20% of qualified business income
- 20% of taxable income net of capital gains

If a taxpayer's income exceeds certain threshold amounts (\$383,900 for a married filing joint return, \$191,950 for other filing statuses) an additional limit is phased in based on

- the greater of:
 - o 50% of total W-2 wages paid with respect to the qualified trade or business
 - o Sum of 25% of W-2 wages paid with respect to the qualified trade or business plus 2.5% of unadjusted basis immediately after acquisition of all qualified property plus 25% of qualified REIT dividends and publicly traded partnership income

The phase in is complete for a taxpayer whose taxable income equals or exceeds \$483,900 on a joint return or \$241,950 for other filing statuses.

Taxpayers in service-related businesses are eligible for the QBI deduction; however, for certain specified service trades or businesses the deduction is phased out if the taxpayer's taxable income exceeds \$191,950 (\$383,900 for married taxpayers filing jointly).

The QBI deduction is available for taxpayers regardless of whether they itemize deductions or take the standard deduction. The deduction reduces taxable income.

Certain dividend income from publicly traded partnerships and Real Estate Investments Trusts also qualifies for the QBI deduction.

There are many complexities involving the QBI deduction. Review IRC Section 199A and the full text of the TCJA for a full understanding of the deduction.

Individuals and eligible estates and trusts that have QBI use Form 8995 to figure the QBI deduction if:

- They have QBI,
- qualified REIT dividends, or
- qualified PTP income or loss (all defined later),
- Their 2024 taxable income before their QBI deduction is less than or equal to \$191,950 if single, head of household, Qualifying Surviving Spouse, or are a trust or estate, \$191,950 if married filing separately, or \$383,900 if married filing jointly,
- They aren't a patron in a specified agricultural or horticultural cooperative.

Otherwise, use Form 8995-A, Qualified Business Income Deduction, to figure the QBI deduction.

2.15.4 Kiddie Tax

The SECURE Act restated the kiddie tax, which is the tax on certain children with unearned income, applied to the unearned income of any child who:

- a) Was under age 19 at the end of the tax year (under age 24 for fulltime students)
- b) Had at least one living parent at the end of the tax year
- c) Had unearned income more than \$2,600 in 2024
- d) Didn't file a joint return

The unearned income of the child is taxed at their parents' marginal federal income tax rate (unless the child's rate is higher).

A child's earned income is still to be taxed according to his or her own individual tax bracket. For tax year 2024, the Kiddie Tax rule kicks in when a child's unearned income exceeds \$2,000.

Use Form 8615, Tax for Certain Children Who Have Unearned Income, to report and pay tax with the child's tax return. Form 8615 must be filed for any child who meets all the following conditions:

1. The child had more than \$2,500 of unearned income.
2. The child is required to file a tax return.
3. The child either:
 - a. Was under age 18 at the end of 2024,
 - b. Was age 18 at the end of 2024 and didn't have earned income that was more than half of the child's support, or

- c. Was a full-time student at least age 19 and under age 24 at the end of 2024 and didn't have earned income that was more than half of the child's support.
4. At least one of the child's parents was alive at the end of 2024.
5. The child doesn't file a joint return for 2024.

For these rules, the term “child” includes a legally adopted child and a stepchild. These rules apply whether the child is dependent. These rules don't apply if neither of the child's parents were living at the end of the year.

Use Form 8814, Parents' Election to Report Child's Interest and Dividends, to report and pay tax with the parents' tax return.

2.15.5 Section 529 Plans

Qualified tuition programs, also known as “529” plans, provide a tax advantaged savings plan to encourage individuals to save for future education expenses. Anyone can make nondeductible contributions to a 529 plan on behalf of a designated beneficiary. Earnings on contributions generally accumulate tax-free. Distributions from a 529 plan used for the designated beneficiary's qualified education expenses are excludable from income.

Eligible expenses include:

- Tuition, fees, and expenses for books, supplies, and equipment required for enrollment in an eligible institution
- Tuition for enrollment or attendance at an elementary or secondary public, private, or religious school up to \$10,000 per year

- Special needs services
- Room and board for a student enrolled at least half-time
- Computer and peripheral equipment, software, and internet access to be used by the beneficiary while enrolled at an eligible post-secondary school.

The SECURE Act expanded the benefits of the 529 plans adding student loan repayments and the cost of an apprenticeship as qualified expenses.

Principal and interest payments made toward a qualified education loan will be considered qualified 529 plan expenses; however, the portion of the payment designated for interest is not eligible for the student loan interest deduction if paid by distributions from a qualified tuition plan. The SECURE Act includes a lifetime limitation of \$10,000 in qualified student loan repayments per 529 plan beneficiary and \$10,000 for each of the beneficiary's siblings.

The new law also allows for tax-free distributions from 529 plans to pay for fees, books, supplies, and equipment for a registered apprenticeship program.

2.15.6 ABLE accounts

Achieving a Better Life Experience (ABLE) accounts are tax-advantaged savings plans for individuals with disabilities and their families. Regardless of state residency, eligible individuals can choose any state's program. Eligible individuals and their families will be allowed to establish ABLE savings accounts that will not affect their eligibility for SSI, Medicaid, and means-tested programs such as FAFSA, HUD and SNAP/food stamp benefits.

Contributions made to ABLE accounts aren't tax deductible on a taxpayer's federal return, and distributions from ABLE accounts used for qualified disability expenses are generally not taxable.

Generally, the total annual contribution allowed by all participating individuals is the gift tax limit for the tax year. In 2024, that is \$18,000. Only one ABLE account is allowed per disabled individual.

Note: The total limit over that could be made to an ABLE account will subject to the individual state and their limit for education-related 529 saving accounts.

The TCJA made some changes to ABLE accounts including a limitation increase for contributions made by the designated beneficiary of the ABLE account. After the overall limitation on contributions is reached, an ABLE account's designated beneficiary can contribute an additional amount up to the lesser of:

- the federal poverty line for a one-person household
- the individual's compensation for the taxable year

The designated beneficiary of an ABLE account can now claim the saver's credit for contributions to his or her ABLE account.

2.15.7 Cancellation of Student Debt

The TCJA provides that certain student loans that are discharged on account of death or total and permanent disability are excluded from gross income. This provision applies for debts discharged after December 31, 2017, through December 31, 2025.

In March 2021, the ARPA deemed student loan forgiveness to not be taxable for the period after December 31, 2020, through December 31,

2025, Student loan forgiveness should not be included in gross income if there is no provision for the student to provide any services to the discharging lender. This exclusion applies to both partial and full discharge of loans.

2.15.8 Net Operating Loss (NOL)

The special rules in section 172 permitting 5-year carrybacks for 2018, 2019, and 2020 net operating losses (NOLs) added by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) of 2020 have expired.

Generally, you can only carry NOLs arising in tax years ending after 2020 to a later year.

- The NOL deduction is limited to 80% of taxable income
- An NOL carryforward is adjusted to consider the 80% limitation
- An NOL may be carried forward indefinitely.

Please note that there is an exception to the new no-carryback provision. Any part of an NOL that is derived from farming loss can be carried back two preceding tax years.

2.15.9 Premium Tax Credit, including no income cap through 2025 (Inflation Reduction Act)

Under the Affordable Care Act, individuals must have minimum essential healthcare coverage, qualify for an exemption, or pay a penalty. The TCJA made some considerable changes to those requirements.

For tax year 2018, the requirements of the original Affordable Care Act were still in place. Non-exempt individuals must have minimum essential

health coverage or pay the “shared responsibility payment.” The individual shared responsibility payment is the greater of a percentage of household income in excess of filing threshold or a flat dollar amount with the payment capped at the cost of the national average premium for a bronze level plan through the marketplace.

For 2018, the penalties are the greater of:

- 2.5% of household income above filing threshold
- \$695 per adult and \$347.50 per child with a family maximum of \$2,085

For tax years after 2018, the TCJA reduces the individual shared responsibility payment to \$0.

Taxpayers who get their health insurance coverage through a Marketplace might be eligible for a premium tax credit. The premium tax credit is a refundable credit intended to help taxpayers with low or moderate income pay for health insurance premiums. The credit can be paid in advance to the taxpayer’s insurance company to lower monthly premiums or can be claimed on the taxpayer’s tax return. If the advance payment is selected, the amount paid in advance will be reconciled on the tax return.

To be eligible for the premium tax credit, the taxpayer must generally meet all the following requirements:

- Health insurance must be purchased through an eligible Health Insurance Marketplace.
- Taxpayer must not be eligible for coverage through an eligible employer or government plan.
- Income must be within certain limits.

- Taxpayer must not file as Married Filing Separately*.
- Taxpayers cannot be claimed as dependents of another.

** Certain victims of domestic abuse may file as Married Filing Separately and still claim the premium tax credit. See Notice 2014-23 for criteria.*

If an individual is eligible for the Premium Tax Credit, he or she can choose too either:

- Get the credit paid in advance directly to his or her insurance company
- Wait to get the credit when his or her tax return is filed

Getting the credit in advance can help lower the monthly premiums and out of pocket expenses. The amount of the credit determined during enrollment at the Marketplace is a projected amount. The actual amount and the credit will be calculated and reconciled on the tax return. If the amount paid in advance was too much, the difference will increase the amount the taxpayer owes, and the tax refund might be reduced or result in a balance due.

If the credit is not paid in advance, it still will be calculated on the tax return and the credit will increase the tax refund or lower the balance due.

Any individual who receives the Premium Tax Credit must file a federal return, even if not otherwise required to do so.

Individuals and families whose household income for the year is between 100% and 400% of the Federal Poverty Line (FPL) for the family size will generally be eligible for the premium tax credit if the other requirements are met.

If an individual was covered by a Marketplace plan at any time during the year, he or she will receive Form 1095-A after the end of the year of coverage reporting information about the coverage. The information on Form 1095-A should be used to reconcile the premium tax credit. In some cases, taxpayers may have received a portion of their premium tax credit in advance to help lower monthly premiums.

Since the premium tax credit is calculated on the tax return, many times the amount paid in advance, if any, is too low or too high. The difference between the premium tax credit calculated on the tax return and the amount paid in advance will affect the amount of the refund or balance due on the tax return. The premium tax credit is reconciled on Form 8962.

If an individual does not reconcile his or her premium tax credit on the tax return, he or she may lose eligibility for the premium tax credit until it is properly reconciled.

In March 2021, the ARPA expanded eligibility for the Premium Tax Credit to individuals with incomes higher than 400% of the FPL. This expansion is only for the tax years 2021 and 2024.

Any taxpayer who has received or has been approved to receive unemployment compensation for any week beginning during 2021, the amount of household income is considered to be no greater than 133% of the federal poverty line. This will generally mean the taxpayer is more likely to qualify for premium tax credit.

2.15.10 Employee Fringe Benefits

The TCJA alters the treatment of qualified transportation fringe provided by employers. No deduction will be allowed for amounts incurred or paid after December 31, 2017, for any expenses incurred for providing

transportation, or any payment or reimbursement, to an employee of the taxpayer for travel between the employee's residence and place of employment, except as necessary for ensuring the employee's safety.

2.15.11 Depreciation of Rental Property

Recovery periods for certain real property improvements have been shortened by the TCJA. For property placed in service after December 31, 2017, the following classes of leasehold improvements have an abbreviated 15-year life with straight-line depreciation:

- qualified leasehold improvements
- qualified retail improvement property
- qualified restaurant property

These three categories are now classified as qualified improvement property. References to qualified leasehold, restaurant, and retail improvements have been eliminated from Section 168.

The TCJA also changes the ADS life of residential and nonresidential property. For residential rental property placed in service after December 31, 2017, the recovery period is shortened from 40 to 30 years. The recovery period for nonresidential rental property remains at 40 years.

2.16 Withholding and estimated tax payments

Pay-As-You-Go Tax

The United States uses a pay-as-you-go tax system for federal income tax which means that tax must be paid as income is earned or received. Individuals should make installments of expected tax liability either through withholding or by making estimated tax payments.

When a tax return is filed after the end of the tax year, the amount paid through withholding or estimated tax payments is reconciled against the actual tax owed calculated on Form 1040 or 1040-SR. If the amount of taxes paid in is more than the tax owed, a tax refund will be due. If the amount paid in is not enough to cover the tax owed, a balance would be due, and the taxpayer would be required to pay that amount by the return due date.

If a taxpayer did not pay enough tax throughout the tax year, either by withholding or by timely estimated tax payments, he or she may be subject to a penalty. Taxpayers can have the IRS figure the amount of the penalty for them or use Form 2210 to calculate the penalty.

Withholding

For most employees, the employer withholds income tax from pay and submits it to the IRS under the employee's name. Tax can also be withheld from other types of income including retirement income, commissions, gambling winnings, and unemployment compensation.

Employers' withholding is usually based upon the amount of pay received and the information included on Form W-4 by the employee.

Taxpayers should use Form W-4P, Withholding Certificate for Periodic Pension or Annuity Payments, to request withholding on periodic pension or annuity payments. (Previously, Form W-4P was also used to request additional withholding on nonperiodic payments and eligible rollover distributions.)

Taxpayers should use Form W-4R, Withholding Certificate for Nonperiodic Payments and Eligible Rollover Distributions, for additional withholding on nonperiodic payments and eligible rollover distributions.

Income statements, such as Forms W-2, 1099-MISC, 1099-NEC, W-2G, 1099-R, etc. should be provided to the taxpayer after the end of the tax year to not only report income received but also to report withholding submitted to the IRS on behalf of the taxpayer.

Estimated Tax Payments

For income not subject to withholding, estimated tax payments should be made throughout the tax year. This includes income from self-employment, certain alimony payments, rents, prizes, and gains from the sale of assets. Taxpayers can make estimated tax payments if their withholdings from salary or other income is not sufficient.

Estimated tax payments are used to pay both federal income tax and self-employment tax. Generally, taxpayers should make estimated tax payments for 2024 if:

1. There is an expectation of at least a \$1,000 balance due for 2024 (after subtracting refundable credits and withholdings)
2. The sum of withholdings and refundable credits are expected to be less than the smaller of:
 - 90% of the tax shown on the 2024 tax return
 - 100% of the tax shown of the 2022 return

Note: Special rules apply for farmers, fishers, certain household employers, and higher income taxpayers. IRS Publication 505 has more information on these and other exceptions.

The estimated tax payments should be made quarterly during the tax year. Payment periods and due dates for calendar year taxpayers are:

Payment Period	Due Date	Tax Year 2024 Due Date
January 1 – March 31	April 15	April 15, 2024
April 1- May 31	June 15	June 16, 2024
June 1 – August 31	September 15	September 16, 2024
September 1 – December 31	January 15, next year	January 15, 2025

If the due date falls on a Saturday, Sunday, or legal holiday, the payment will be due on the next day that is not a Saturday, Sunday, or legal holiday.

If the 2024 tax return is filed by February 1, 2025, and tax is paid in full, the payment due on January 15, 2025, is not needed.

2.17 Balance due and refund options

Payments Options

At the end of the tax year, taxpayers usually have a balance due to the IRS or a refund due. If a balance is due and is more than \$1, the payment should be made by the return due date, usually April 15 for calendar-year taxpayers. Even if an automatic extension is filed, the time to pay tax due is not extended. If a balance due is not paid by the return due date, interest and penalties can be assessed.

There are several different payment options available for taxpayers. Payments may be made electronically, by phone, or by mailing a check or money order. If the taxpayer's return is e-filed, the payment may also be made via electronic funds withdrawal, or by credit or debit cards. Information on payment options is available at www.irs.gov/e-pay.

Payments can also be made through the Electronic Federal Tax Payment System (EFTPS), a free tax payment system for online and phone payments.

If the taxpayer cannot pay the full amount due, the taxpayer can request an installment agreement. If accepted, the taxpayer can make installments on the tax due. Penalties and interest might still be charged even if the installment agreement is granted. To request an installment agreement, file Form 9465 or apply online.

Taxpayers may also file Form 1127, Application for Extension of Time for Payment of Tax Due to Undue Hardship, to request an extension of time to pay. This extension generally is not granted for more than six months. "Undue hardship" is more than an inconvenience; taxpayers must show they will have a substantial financial loss if taxes are paid on the date due and must attach supporting documentation.

Refund Options

If an overpayment is calculated when the return is complete, the taxpayer might be due a refund. If filing Form 1040, the taxpayer can choose to apply all or part of the overpayment to next year's estimated tax. In some cases, it is possible the taxpayer's refund could offset amounts owed for past-due federal tax, state income tax, unemployment compensation debts, child or spousal support and other federal debts.

Offsets are made by the Treasury Department's Bureau of the Fiscal Service, unless it is a federal tax debt which is offset by the IRS. Taxpayers will be notified if their refund has been offset.

Taxpayers have three options for receiving their individual federal income tax refund:

- Direct deposit
- Purchase of U.S. Series I Savings Bonds
- Paper check

Direct Deposit of Refund

Taxpayer can have their refund deposited directly into a checking or savings account, including an Individual Retirement Arrangement (IRA), in the United States financial institution.

Taxpayers can also request to have all or some of the refund deposited into a Treasury Direct® online account to buy U.S. Treasury marketable securities and savings bonds. In addition, up to \$5,000 of the refund can be directly allocated to buy paper Series I savings bonds (not through Treasury Direct).

If the taxpayers choose direct deposit, they may be able to split the refund and have it deposited among two or three accounts using Form 8888, Allocation of Refund.

For returns that are e-filed, direct deposits are usually sent in fewer than 21 days from the date of return acceptance by the IRS. If an accurate and complete tax return is paper filed, the direct deposit could take more than six weeks. Taxpayers can use the online tool, Where's My Refund at

www.IRS.gov, to check the status of their refund, or they can call the Refund Hotline at 1- 800-829-1954.

Additional Direct Deposit Requirements

Preparers must never charge a separate fee for direct deposit and must accept any direct deposit election by a taxpayer to any eligible financial institution. The preparer must advise taxpayers they cannot rescind a direct deposit election, and they cannot make changes to the routing transit numbers of financial institutions or account numbers after IRS has accepted the return. The preparer must not alter the direct deposit information in the electronic record after taxpayers have signed the tax return.

Example:

Jerry is expecting a refund of \$400. He chooses to deposit \$150 into his checking account, \$150 into his savings account, and \$100 into an IRA account.

In January 2015, the IRS imposed new limits on direct deposited refunds to combat fraud. The number of tax refunds electronically deposited into a single account will be limited to three. Additional refunds sent to the account will automatically be converted to a paper refund check and be mailed to the taxpayer. The IRS will notify taxpayers that the intended account has exceeded the direct deposit limits, and a paper check will be issued.

This limit applies to financial accounts, such as bank savings or checking accounts, and to prepaid, reloadable cards and debit cards.

Purchasing U.S. Series, I Savings Bond with Tax Refund

Taxpayers can elect to use all or part of the tax refund to purchase U.S. Series I Savings Bonds using a Treasury Direct® online account, or by paper. Bonds must be purchased in increments of \$50 up to a total of \$5,000. Any unused refund amount can be refunded via paper check or direct deposit. Use form 8888.

A bank account is not required to purchase the paper Series I bonds, nor is it required to open an account in advance with the Treasury Department.

Paper Series I savings bonds are ordered after the IRS completes processing the tax return. Once the bonds are ordered, it may take up to three weeks for the taxpayer to receive the paper Series I bonds in the mail.

Direct Depositing into a Treasury Direct online account

Taxpayers can request a direct deposit of all or a portion of a tax refund to an existing Treasury Direct online account. The funds can then be used to purchase any US Treasury marketable securities. File Form 8888, Allocation of Refund to do so.

Example:

Venus has a refund of \$20,000 on her 2024 return. For example, on Form 8888, she could request Part I Direct Deposit \$8,000 to her personal checking account, \$7,000 to her Treasury Direct account, and Part II US Series I Savings Bonds Purchases \$5,000 be used for paper US Series I Savings Bond Purchases.

Refund Checks

If a direct deposit is not indicated, a taxpayer will receive a paper check in the mail. Taxpayers should cash a tax refund check soon after it is received. Checks expire the last business day of the 12th month of issue. If the check has expired, the taxpayer can apply to the IRS to have it reissued.

Other notes regarding refund checks:

- If the taxpayers receive a check for a refund they are not entitled to, or for an overpayment that should have been credited to estimated tax payments, the check should not be cashed. Instead, contact the IRS. Normally the IRS will tell the taxpayer to write “VOID” in the endorsement section on the back of the check and to return it to a designated IRS location with a letter of explanation.
- If the taxpayer receives a check for more than the refund claimed, he or she should not cash the check until the taxpayer receives a notice explaining the difference.
- If the refund check is for less than what was claimed, it should be accompanied by a notice explaining the difference. Cashing the check does not stop the taxpayer from claiming an additional amount of refund.

If the taxpayer does not receive a notice and he or she has any questions about the amount of the refund, wait two weeks. If the taxpayer still has not received a notice, contact the IRS.

2.18 Tax return due date and filing for Extensions

Return Due Dates

Individual tax returns are due the fifteenth day of the fourth month after the close of the tax year, deeming April 15 as the due date for taxpayers using the calendar year. If the due date falls on a Saturday, Sunday, or legal holiday, the due date is then delayed until the next business day.

The IRS considers a paper return “on time” when it arrives with a proper address and sufficient postage and bears a postmark on or before the due date. A return sent using IRS e-file is on time if the authorized electronic return transmitter postmarks the transmission by the due date.

If a U.S. citizen or resident has a main place of business located outside of the United States or Puerto Rico, he or she is allowed an automatic extension until June 15 to file and pay tax that is due. This also applies to members of the military stationed outside the United States or Puerto Rico. If taxpayers use an automatic extension, a statement must be attached to the return showing the requirements were met for the extension.

Returns should be filed when they are due. Failure to file can be costly, and a delay in filing may result in a late penalty and interest charges.

Extensions

If more time is needed to file a return, a taxpayer might be able to get an automatic six-month extension by filing Form 4868 no later than the return due date; however, the extension of time to file does not extend the time to pay tax due. If the tax due is not paid by the original return due date, interest and penalties could be charged. Form 4868 can be filed electronically through e-file or via U.S. Mail.

October 15 is the final due date for all calendar year returns that have been extended.

Example:

Bill and Rose needed more time to file their 2024 federal tax return. On April 6, 2025, they filed Form 4868 for an automatic six-month extension of time to file. Since they expected to have a balance due of \$500 with their tax return, they remitted that amount with the extension filed in April because Form 4868 does not extend the time to pay tax, only the time to file.

Combat Zone

Deadlines are extended for certain taxpayers serving in a combat zone or a contingency operation in support of the Armed Forces. When individuals serve in a qualified combat zone, the deadline for filing and payment increases by 180 days after the latter of the last day in a qualified combat zone or the last day of a continuous hospitalization related to injury from service. In addition to the 180 days, a service member in a qualified combat zone can receive a deadline extension of up to three and a half months, based on the number of days remaining to file upon entering the combat zone. This period is representative of the time normally allotted for filing taxes (January 1–April 15). If entering the combat zone before the first of the year, the service member may add the entire three and a half months to the 180-day extension.

The term combat zone is a general term that includes all the following hostile areas where the military may serve—actual combat areas, direct combat support areas, and contingency operations areas. A contingency operation is a military operation that is designated by the Secretary of Defense or results in calling members of the uniformed services to active

duty (or retains them on active duty) during a war or a national emergency declared by the President or Congress.

There are multiple classes of taxpayers serving in the combat zone that qualify for the same treatment:

- US Armed forces such as the Army, Navy, Air Force, Marine Corps, and Coast Guard
- Uniformed services, which includes merchant marines, and the commissioned corps of the National Oceanic and Atmospheric Administration (NOAA) and the Public Health Service
- Support personnel, such as the Red Cross
- Civilian personnel acting under the direction of the US Armed Forces in support of combat forces

Course Domain 3 –Practices, Procedures and Professional Responsibility

Domain 3 of the AFTR course is a general review of the practices, procedures, and professional responsibilities for tax return preparers.

Objectives

After completing Domain 3, participants should be able to:

- Learn ways to safeguard taxpayer data and prevent tax-related identity theft
- Understand ITIN parameters
- Identify penalties assessed to tax return preparers
- Summarize due diligence requirements
- Recall e-file requirements
- Identify Annual Filing Season Program (AFSP) requirements

3.1 Tax-Related Identity Theft (Pub. 5199)

Tax return preparers should be especially diligent in recognizing fraud and abuse, reporting it to the IRS, and preventing it when possible. Fraudulent returns are sometimes filed by individuals using someone else's name or SSN, or by presenting fabricated or forged documents.

The IRS issued Publication 5199, Tax Preparer Guide to Identity Theft, to inform practitioners of the potential warning signs of identity theft and provide resources to assist victims.

For more information, see Publication 5199 and Publication 4557, Safeguarding Taxpayer Data.

Security Summit

In 2015, the IRS joined with key individuals from the tax software industry, tax preparation firms, payroll and tax financial product processors, and state tax administrations to help protect US taxpayers from the alarming increase in tax-related identity theft and refund fraud. As of 2022, membership includes 42 state agencies and 20 industry officials, in addition to the IRS.

The Security Summit partners have convened several working groups to enact new safeguards to combat fraud and theft. There are six work groups with specific tasks assigned. Some actions taken include:

- Launching security awareness campaigns for taxpayers and tax professionals
- Enhancing authentication standards in payroll and tax software programs
- Improving communication between agencies to provide alerts for questionable activity

Many of the safeguards implemented by the Security Summit happen behind the scenes and remain invisible to both taxpayers and tax professionals.

Warning Signs of Tax-Related Identity Theft

In tax-related identity theft, thieves usually use stolen SSNs to file false tax returns to claim a fraudulent refund. These criminals generally try to file the fraudulent return early in the filing season. Taxpayers may be unaware that their identity has been compromised until attempting to file their return.

Warning signs of tax-related identity theft for individual clients include:

- A rejected return with IRS rejects codes which indicate the taxpayer's SSN has already been used on a previously accepted return.
- A taxpayer received unexpected IRS notices that do not correlate to tax returns filed.
- An IRS notice indicating a taxpayer received wages from an employer who is unknown to him or her.

Assisting Victims of Tax-Related Identity Theft

If a taxpayer's SSN has been compromised, or it is suspected that he or she is a victim of tax-related identity theft, the following steps are recommended:

- File a report with local police.
- File a complaint with the Federal Trade Commission (FTC) at www.identitytheft.gov or the FTC Identity Theft Hotline at:
1-877-438-4338 (877-ID-THEFT).
- Contact one or more of the three major credit bureaus to place a fraud alert on credit records:
Equifax.com 1-800-525-6285
Experian.com 1-888-397-3742
TransUnion.com 1-800-680-7289
- Review all credit reports with the credit bureaus.
- Close any accounts opened fraudulently.

- Contact check verification companies if bank account compromised
Check Rite Systems 701-214-4123.
Tele-Check 800-710-9898
Chex Systems 800-328-5121
- Respond immediately to any IRS notice by calling the number provided.
- Complete IRS Form 14039, Identity Theft Affidavit, then mail or fax it according to the instructions.
Continue to file returns and pay tax if needed, even if it is necessary to paper-file returns.
- Contact appropriate state tax agencies

If a taxpayer has contacted the IRS but has no resolution, call the Identity Protection Specialized Unit on 1-800-908-4490.

NOTE: Preparers must have power of attorney on file before an IRS customer service representative can provide them with any taxpayer information.

Remind taxpayers that the IRS does not initiate contact with individuals by email or text messages to request personal or financial information.

3.2 Safeguarding Taxpayer Data (Pub. 4557)

As thieves have become more sophisticated and continue to adapt their tactics to compromise data, it is imperative that tax professionals take the necessary steps to protect themselves and their clients from theft and fraud. The IRS has published Publication 4557, Safeguarding Taxpayer

Data, to give tax professionals a guide and some best practices in handling taxpayer data.

Use Publication 4557 to get started and put the proper safeguards in place.

System Security

Tax preparers should do the following to protect taxpayer and their own data:

- Take basic security steps including strong internal controls, antimalware software, firewalls, passwords, and backups.
- Check e-file applications and PTIN accounts regularly for activity
Secure wireless networks and remote access, including PCs and printers
- Protect stored client data with strong encryption and regular backups
- Train staff to recognize phishing scams
- Use strong web browsing protection software
- Have a written security plan and follow it

Verification of Taxpayer Identification Numbers

To safeguard taxpayer information and prevent fraud and abuse, it is critical that EROs and tax return preparers confirm identities and identification numbers of taxpayers, spouses, and dependents listed on returns. Preparers should confirm Social Security Numbers (SSNs), Employer Identification Numbers (EINs), Adoption Taxpayer Identification Numbers (ATINs), and Individual Taxpayer Identification Numbers (ITINs).

To verify the identities, preparers should ask taxpayers to provide two forms of identification, with at least one being a government-issued photo ID. Preparers should verify the taxpayer's name and current address against the identification supplied. Viewing Social Security cards and ITIN letters for everyone listed on the tax return also helps prevent filing returns with incorrect ID numbers.

Fraudulent Returns

Tax return preparers should be especially diligent in recognizing fraud and abuse, reporting it to the IRS, and preventing it when possible. Fraudulent returns are sometimes filed by individuals using someone else's name or SSN, or by presenting fabricated or forged documents.

The IRS has identified questionable Forms W-2 as a source of abuse. Tax return preparers should be on the lookout for irregular or nonstandard Forms W-2 that are suspicious or altered. It is also important to verify the identification number entered on Form W-2, Wage and Tax Statement. The identification number should match that of the respective taxpayer or spouse on the tax return.

3.3 Overview and Expirations of Individual Identification Numbers (ITINs) (Pub. 1915)

An Individual Taxpayer Identification Number (ITIN) is a tax processing number issued by the IRS to taxpayers who do not have, or are not eligible for, a Social Security Number (SSN). ITINs help taxpayers comply with U.S. tax laws regardless of immigration status.

An ITIN is a nine-digit number which begins with the number 9 and has a range of numbers from 50-65, 70-88, 90-92, and 94-99 as the fourth and fifth digits. It is formatted like a social security number, 9xx-xx-xxxx.

ITINs should be used for federal tax reporting and are not intended to be used for any other purpose. An ITIN does not authorize work in the U.S. or provide eligibility for Social Security benefits.

ITIN Application

To apply for an ITIN, individuals should complete Form W-7, Application for IRS Individual Taxpayer Identification Number. Form W7 can be attached and mailed along with the federal tax return to the IRS. Services of an IRS-authorized Form W-7 Acceptance Agent or some IRS Taxpayer Assistance Center can also be used to submit Form W-7.

ITINs are usually issued within seven weeks of the receipt of complete, qualified applications. Recipients will receive notice CP565, ITIN Assignment Notice.

Filing with an ITIN

If a taxpayer files a return with an ITIN and reports wages, he or she is required to show the SSN under which the wages were earned. This scenario creates an ITIN/SSN mismatch when e-filing. Even though these returns have been rejected when sent via e-file in the past, the IRS system now accepts returns with as ITIN/SSN mismatch. The ITIN should be displayed only at the top of Form 1040 as the identifying number.

If the primary taxpayer or spouse has ITINS, they are not eligible for EIC even if the dependents have valid SSNs.

Notice 2016-48

Prior to the PATH act, a taxpayer applied for and received an ITIN only once. The ITIN remained in effect unless the taxpayer applied for and received an SSN. Under the PATH Act, certain ITINs will no longer be in effect unless they are renewed.

In August 2016, the IRS issued Notice 2016-48, outlining the implementation of the changes for ITINs resulting from the PATH Act of 2015. Certain ITINs must be renewed to be used on a tax return, including unused and expired ITINs.

Unused ITINs

ITINs that have not been used on a federal tax return for three consecutive tax years, either as the ITIN an individual who files the return or as the ITIN of a dependent, will expire on December 31 of the third consecutive year or of nonuse.

Expiring ITINs

ITINs began expiring in 2016 and have continued to expire on a rolling basis regardless of whether they have been used in the three prior years. Older ITINs (ITINs issued before 2013) expire on a rolling basis depending on when they were issued. ITINs issued before 2009 have already expired unless they have been renewed. ITINs issued in 2011 and 2012 expired on January 1, 2020.

Expired ITINs: If an ITIN wasn't included on a U.S. federal tax return at least once for tax years 2018, 2019, 2020, and 2021, the ITIN expired on December 31, 2022.

ITINs with middle digits (the fourth and fifth positions) "70," "71," "72," "73," "74," "75," "76," "77," "78," "79," "80," "81," "82," "83," "84," "85," "86," "87," or "88" have expired.

In addition, ITINs with middle digits "90," "91," "92," "94," "95," "96," "97," "98," or "99," IF assigned before 2013, have expired.

Individuals with an expiring ITIN will be mailed a notification CP48 from the IRS. Failure to renew expired ITINs before filing a tax return could result in refund delays and ineligibility for certain tax credits. Individuals should keep their mailing address current with the IRS to avoid delays in receiving the notices.

3.4 Preparer Penalties Paid Preparers (inflation adjustments to penalty amounts found in Rev. Proc. 2023-34)

According to the IRS, “A paid tax return preparer is any person who is compensated for preparing or assisting in the preparation of all or substantially all of any U.S federal tax return, claim for refund, or other tax form submitted to the IRS (with a few exceptions).”

All paid tax return preparers are required to register with the IRS and obtain a Preparer Tax Identification Number (PTIN) which must be renewed annually. PTIN applicants must be at least 18 years of age.

All paid tax return preparers are subject to the Internal Revenue Code (IRC).

Understatement of Tax Liability IRC §6694

Disreputable behavior by a tax return preparer is not tolerated by the IRC. Penalties will be assessed against tax return preparers for negligent or intentional disregard of rules and regulations, including willful understatement of tax liability under IRC §6694 (a) and §6694 (b).

A penalty can be assessed for each return or claim that shows an understatement of tax liability when the understatement was due to an “unreasonable position” – Code §6694(a).

An unreasonable position is one in which:

- The return preparer knew (or reasonably should have known) of the position
- The preparer did not have a reasonable belief that the position would more likely than not (i.e., greater than 50% chance) be sustained on its merits
- The tax return preparer did disclose but had no reasonable basis for the position According to IRC §6694(a), the penalty for understatement of liability due to an unreasonable position is the greater of \$1,000 for each return or claim that shows such understatement or 50% of the income that the preparer receives (or will receive) for preparing the tax return or claim for refund.

Example:

Bryan, a tax return preparer, prepares and signs Isabel's return. Bryan received a fee of \$1,100 from Becky for his tax return preparation services. After the return is filed and reviewed by the IRS, it is found that there was an understatement of liability on Isabel's return due to an unreasonable position, subjecting John to a penalty. Because 50% of his preparation fee would be \$550 (50% of \$1,100), Bryan would be imposed a fee of \$1,000 ($\$1,000 > \550).

Taking an unreasonable position does not always result in a penalty being imposed if the preparer showed a reasonable basis for the understatement, acted in good faith, or adequately disclosed the position.

Sometimes, an understatement of tax liability is due to the misconduct of the tax return preparer.

A penalty may be imposed IRC §6694(b) if:

- There is an understatement of liability on a return or claim for refund due to a willful attempt in any manner to understate the tax liability by the preparer
- The preparer has recklessly or intentionally disregarded rules or regulations

The IRS §6694(b) penalty is the greater of \$5,000 or 75% of the income derived by the return preparer for each return or claim for refund in violation. If a preparer has been assessed both

§6694(a) and §6694(b) penalties for the same return, the §6694(b) penalty will be reduced by the amount assessed by §6694(a).

Example:

Lorena, a self-employed day care provider, claims various business expenses. Upon review, Anthony, the tax return preparer, notices that Lorena has included amounts paid for lawn service at his home as an expense. Even though Anthony recognizes the expenses for lawn care should be deemed as personal and nondeductible, he still deducts them on Lorena's Schedule C and does not disclose the deductions as questionable. After an IRS review, a penalty is imposed upon Anthony for intentional and willful understatement of tax liability. Anthony charged Lorena a fee of \$250 to prepare the return; therefore, Anthony will be assessed a \$5,000 penalty since it is greater than 75% (\$187.50) of the income derived from the return.

IRC §6695

IRC §6695 provides seven distinct penalties that may be assessed on a tax return preparer for actions related to disclosures and client dealings, including:

- Failure to furnish copy to taxpayer (§6695(a))
- Failure to sign return (§6695(b))
- Failure to furnish identifying number (§6695(c))
- Failure to retain copy or list (§6695(d))
- Failure to file correct information returns (§6695(e))
- Negotiation of check (§6695(f))
- Failure to be diligent in determining eligibility for certain tax benefits (§6695(g))

Furnish Copy to Taxpayer

Preparers are required to furnish a completed copy of a return or claim for refund no later than the time the return is presented to the taxpayer for his or her signature.

Under IRC §6695(a), tax return preparers shall pay a penalty of \$60 for each failure to provide a copy of the return or claim for refund to the taxpayer. If the preparer can show the failure was due to a reasonable cause and was not due to willful neglect, the penalties could be reduced.

The maximum penalty imposed upon a preparer for failure to provide copies of filed documents during any tax year is \$31,500.00.

Return Signature Requirements

Tax return preparers are also required to sign returns and claims for refunds they prepare. Failure to do so will result in a \$60 penalty under IRC §6695(b) for each failure unless it can be shown that the failure was due to reasonable cause and not willful neglect. The maximum penalty assessed to a person is \$31,500 for documents filed during any calendar year.

Furnish Preparer Identifying Number

Section 6109 (a)(4) requires preparers to furnish on tax returns and claims for refund an identifying number, specifically a Preparer Tax Identification Number (PTIN). This ensures proper identification of the return preparer, the preparer's employer, or both.

Preparers who fail to provide their PTIN on the tax return or claim for refund are subject to penalty under IRC §6695(c) unless the omission was due to reasonable cause and not willful neglect. A penalty of \$60 for each failure will be imposed with a maximum of \$31,500 with respect to a return period.

Retention of Tax Return Copies or Lists

Tax return preparers who prepare any return or claim for refund should, for three years after the end of the return period:

- Retain a completed copy of tax returns or claims for refund or retain a list that has the taxpayers' names and identification numbers for whom the returns were prepared
- Be able to make copies or lists available for inspection upon request

Preparers may be penalized for failure to keep copies of returns or lists under IRC §6695(d). A penalty of \$60 for each failure will be imposed unless it is shown the failure is due to a reasonable cause and not due to willful neglect. The maximum penalty for failure to retain copies filed during a calendar year should not exceed \$31,500.

Prohibition of Negotiation of Taxpayer Refunds

Under IRC §6695(f), tax return preparers are strictly prohibited from negotiating or endorsing any federal tax refund check for a return that they prepared. A penalty of \$635 is imposed for each such violation. There is no maximum penalty limit. Exceptions apply to tax preparation firms that are also financial institutions.

3.5 Due Diligence in Tax Preparation (for filing as head of household, earned income tax credit, child tax credit, and American opportunity tax credit)

The penalty for 2024 is \$635 for failure.

Tax return preparers must comply with due diligence requirements when determining:

- Eligibility to file as Head of Household
- Eligibility for, or the amount of credit allowable, for the:
 - o Earned Income Tax Credit
 - o Child Tax Credit
 - o American Opportunity Tax Credit
 - o Credit for Other Dependents

Any tax return preparer who fails to comply with the due diligence requirements will be subject to a penalty of \$600 for each failure. There is no maximum penalty limit.

Due Diligence Requirements

Tax return preparers who prepare any return or claim for refund that includes the Earned Income Tax Credit (EITC), Child Tax Credit (CTC), Credit for Other Dependents (ODC) or the American Opportunity Tax Credit (AOTC) must meet specific due diligence requirements. Due diligence requirements also apply to returns that have taxpayers filing as Head of Household.

Failure to comply with due diligence requirements with respect to determining eligibility for, or the amount of, EITC could lead to a \$600 penalty for each such failure under IRC §6695(g).

There is no maximum penalty limit. In addition to monetary penalties, return preparers or tax return preparation firms can also face suspension or even expulsion from IRS e-file, other disciplinary action from the IRS Office of Professional Responsibility, and injunctions prohibiting the preparer from preparing tax returns or restricting the types of tax returns that may be prepared.

The IRS can also penalize an employer or employing firm if an employee fails to comply with the EITC due diligence requirements.

There are four basic due diligence requirements for preparers for EITC, CTC, AOTC, ODC, and the Head of Household (HOH) filing status:

- Completing and Submitting the Eligibility Checklist – Form 8867
- Computing the Credit
- Knowing and Understanding Rules and Regulations
- Keeping Records

Form 8867 Eligibility Checklist

Paid preparers who prepare returns with items requiring due diligence must complete and submit Form 8867, Paid Preparer’s Due Diligence Checklist. This checklist helps the preparer consider all the eligibility criteria for claiming not only EITC, but also CTC, AOTC, ODC and HOH filing status.

Form 8867 should be completed based on information provided to the preparer by the taxpayer. Eligibility questions should be posed to taxpayers in language the taxpayer understands. Ask open questions to get more information than “yes” or “no.” At the time of the interview, preparers should document any additional questions that were asked of the taxpayer and their replies.

Return preparers need to answer the questions covering eligibility on Form 8867 using information from the taxpayers. The IRS recommends using words and terms clients know and won’t misunderstand.

For example:

- Instead of asking “What’s your marital status?” ask “Are you single or married?”

- Instead of asking “Are you the head of the household?” find out if they qualify for Head of Household by asking the right questions.
- Don’t ask if they have a qualifying child or dependent, find out who they lived with during the tax year and for how long.

For e-filed returns, Form 8867 must be submitted electronically. If a return is not e-filed, Form 8867 must be attached to any paper return that is prepared and filed. If a preparer prepares the return but does not submit it to the IRS, he or she must still provide Form 8867 to be sent with the filed tax return.

Computing the Credit

Preparers should complete any applicable worksheets needed to compute credits. Worksheets can be found in the Forms 1040 or 1040-SR instructions or in IRS publications. Any alternative document with the same information can be used. Most tax return preparation software includes computation worksheets.

The worksheets show all the items that should be included in the credit computations including self-employment income, total earned income, investment income, and adjusted gross income.

Knowledge Requirement

Preparers should know the law regarding items with required due diligence and ask the appropriate questions to collect all relevant facts. Preparers should take into account the information the taxpayer provides and what the preparer knows about the taxpayer and apply a commonsense standard. The preparer should not know or have any reason to know any information used to determine taxpayer’s eligibility or the amount of the credit is incorrect, inconsistent, or incomplete. It is the duty of the preparer

to determine if the information is complete and to gather any missing facts. It is also important to recognize contradictory statements or statements known not to be true.

Preparers should also make additional inquiries if a reasonable and well-informed tax return preparer knows the information is incorrect, inconsistent, or incomplete. Additional questions asked and the taxpayer's answers to the questions should be documented at the time of the interview.

Record Keeping

Preparers must keep adequate records to satisfy due diligence requirements. Records can be kept either in paper or electronic format. A backup of the records should also be kept in a secure off-site location. Preparers should be sure that they can retrieve records at the IRS's request. Preparers should retain the following documents:

- Form 8867
- Computation worksheets
- Copies of any documents provided by the taxpayer on which the preparer relied to complete Form 8867 or worksheets
- Records of when, how, and from whom the information was obtained to prepare the return

These above documents should be kept three years from the latest of:

- The due date of the tax return
- The date the tax return was electronically filed or, if paper-filed, the date the return was presented for the taxpayer's signature

- The date in which the return is given to the signing tax return preparer (if no signing preparer)

Self-Employed Individuals and Due Diligence

Preparers should carefully consider due diligence for taxpayers who are self-employed. An individual is considered self-employed if he or she carries on a trade or business with a profit motive as a sole proprietor or as an independent contractor. It could also be an individual who performs services on a part-time basis or does occasional “odd jobs” and receives compensation for that work. These taxpayers don’t necessarily need a business name or formal business structure to be considered self-employed. These individuals are required to report the income and related expenses from selling goods or performing services for others for money.

Schedule C Red Flags

Some red flags for return preparers to watch for are:
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- Schedule C income in round numbers
- Schedule C cash businesses as the only income claiming EITC
- Schedule C with little or no expenses when expenses would be expected
- Schedule C taxpayers with little or no receipts for income and expenses
- Any Schedule C income that brings the taxpayer to the maximum credit allowed
- Schedule C without Form 1099 (if possible)

3.6 e-File Compliance e-File Mandate (e.g., no pay stub filing when to get signature form, timing for handling rejects)

Any tax return preparer who anticipates preparing and filing 11 or more Forms 1040 or 1040-SR and Forms 1041 during a calendar year must use IRS e-file to submit returns. There are some exemptions and preparers may seek approval of a hardship waiver.

In some cases, taxpayers choose to submit their return to the IRS themselves even if prepared by an IRS authorized e-file provider. In this situation, preparers should obtain and keep a signed and dated statement from the taxpayer documenting the taxpayer's choice. Form 8948, Preparer Explanation for Not Filing Electronically, should be completed and attached to the taxpayer's paper return.

If a preparer wishes to seek approval for a hardship waiver, Form 8944, Preparer e-file Hardship Waiver Request, generally should be filed with the IRS no later than February 15 of the year for which the waiver is being requested. Some reasons preparers may request a waiver include bankruptcy, financial problems, or the preparer is in an area declared a Presidential Disaster Area. Hardship waivers are not commonly approved. The decision to approve a waiver is based on a preparer's circumstances and is reviewed on a case-by-case basis. Requests for a hardship waiver based solely on personal desire of the preparer or the lack of computer or software will be denied. If a waiver is granted, Form 8948 should still be attached to client returns with box 2 checked and applicable information included.

Taxpayer Signatures for e-File

Both taxpayers and preparers must electronically sign returns submitted to IRS through e-file. Taxpayers must sign and date the Declaration of

Taxpayer to authorize the electronic submission of the return to the IRS before it is transmitted. The Declaration of Taxpayer includes the taxpayer's declaration under penalties of perjury that the return is true and correct. If any changes are made to the return after the taxpayers have signed the declaration that results in more than either \$50 difference in total income or AGI or \$14 to total tax, Federal income tax withheld, refund, or amount owed, then the declaration must be signed again before the return can be transmitted.

Declaration of Taxpayer

Under penalties of perjury, I declare that I have examined a copy of my electronic individual income tax return and accompanying schedules and statements for the tax year ending December 31, 2024, and to the best of my knowledge and belief, they are true, correct, and complete.

“I further declare that the amounts in Part I above are the amounts from my electronic income tax return.”

“I consent to allow my intermediate service provider, transmitter, or electronic return originator (ERO) to send my return to the IRS and to receive from the IRS:

- (a) an acknowledgement of receipt or reason for rejection of the transmission,
- (b) the reason for any delay in processing the return or refund, and
- (c) the date of any refund. If applicable.”

“I authorize the U.S. Treasury and its designated Financial Agent to initiate an ACH electronic funds withdrawal (direct debit) entry to the financial institution account indicated in the tax preparation software for

payment of my federal taxes owed on this return and/or a payment of estimated tax, and the financial institution to debit the entry to this account”.

This authorization is to remain in full force and effect until I notify the U.S. Treasury Financial Agent to terminate the authorization.

To revoke (cancel) a payment, I must contact the U.S. Treasury Financial Agent at 1-888-353-4537. Payment cancellation requests must be received no later than 2 business days prior to the payment (settlement) date. I also authorize the financial institutions involved in the processing of the electronic payment of taxes to receive confidential information necessary to answer inquiries and resolve issues related to the payment.

I further acknowledge that the personal identification number (PIN) below is my signature for my electronic income tax return and, if applicable, my Electronic Funds Withdrawal Consent.

For taxpayers, there are two methods of signing individual tax returns with an electronic signature. Both methods include the use of a Personal Identification Number (PIN) to sign the return and the Declaration of Taxpayer.

The methods are:

- Self-Select PIN
- Practitioner PIN

The Self-Select PIN requires the taxpayer to provide the prior-year PIN and AGI amount. This method can be completely paperless if the taxpayer enters the PIN directly into the electronic return. Taxpayers can authorize

EROs to enter the PIN on their behalf, in which case the taxpayer must sign a consent form after reviewing the return.

Some taxpayers are ineligible to use a Self-Select PIN, including primary taxpayers under age 16 who have never filed a return and secondary taxpayers under age 16 who did not file a prior- year return.

Using the Practitioner PIN does not require the use of prior-year PIN and AGI amount. A Practitioner PIN always requires taxpayers to sign their consent even if the PIN was entered into the return by the taxpayer. EROs may select and enter a Practitioner PIN. Some tax software programs automatically generate the PIN for the taxpayers.

An IRS e-file signature authorization is needed for both Self-Select PINs not entered in directly by the taxpayer and Practitioner PINs. Form 8879, IRS e-File Signature Authorization, authorizes an ERO to enter the taxpayer's PIN on individual returns. Form 8878, IRS e-File Authorization for Application of Extension of Time to File, authorizes the ERO to enter the taxpayer's PIN on Forms 4868 and 2350. Both Forms 8879 and 8878 include the Declaration of Taxpayer.

EROs must also sign tax returns with a PIN, which should be the same PIN throughout the entire filing season. EROs may authorize other members of their practice or firm to sign on their behalf; however, the ERO is still responsible for the return.

Forms 8879 and 8878 should be retained for three years from the return due date or the date the IRS received the return, whichever is later.

Timing of Filing

Once the return is signed, the Electronic Return Originator (ERO) must submit the return electronically as quickly as possible and ensure that stockpiling does not occur.

Stockpiling is either:

- Collecting returns from taxpayers and other authorized e-file providers prior to their acceptance to participate in IRS e-file
- Waiting more than three calendar days to submit a return to the IRS after obtaining all necessary information

Returns held in early season before the IRS accepts any transmissions is not considered stockpiling, but the preparer must advise the taxpayers of the date the IRS will begin accepting returns electronically.

e-File Record Keeping

EROs must retain the following documents and records until the end of the calendar year at the business address from which the return originated or at a location that allows the ERO to readily access the material:

- A copy of Form 8453, US Individual Income Tax Transmittal for IRS e-file Return, and supporting documents that are not included in the electronic records submitted to the IRS
- Copies of Forms W-2, W-2G, and 1099-R
- A copy of signed IRS e-file consent to disclosure forms
- A complete copy of the electronic portion of the return that can be readily and accurately converted into an electronic transmission that the IRS can process

- The acknowledgement file for IRS accepted returns

The above records must be readily available upon IRS request during the retention period.

Forms 8878 or 8879 must be available in the same manner for three years from the return due date or the IRS received date, whichever is later. The Submission ID must be associated with Forms 8878 and 8879.

The Submission ID can be added to Forms 8879 and 8878 or the acknowledgement containing the Submission ID can be associated with Forms 8879 and 8878. If the acknowledgement is kept to identify the Submission ID, it should be kept in accordance with the retention requirements for Forms 8878 and 8879.

Records may be either paper copies or in electronic format.

Documents Required for e-File

Tax return preparers must not file a return prior to receiving Forms W-2, W-2G, or 1099-R. In the event that the taxpayer is unable to obtain correct Forms W-2, W-2G, or 1099-R, a return may be e-filed after Form 4852, Substitute Form W-2, Wage and Tax Statement, or 1099-R Distributions from Pension, Annuities, Retirement, or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., has been submitted. Form 4852 must be completed in compliance with the use of that form. If Form 4852 is used, the nonstandard W-2 indicator must be included in the record and the ERO must maintain Form 4852 in the same manner as Forms W-2, W-2G, and 1099-R.

Example:

Paul is very eager to file his 2024 tax return because he expects to receive a large refund. On January 31, 2025, he takes his last paycheck stub to his tax return preparer because he has not received Form W-2 from his employer. Paul asks his tax return preparer to file the return using the information on his last paycheck stub so he can get his refund as quickly as possible.

The tax return preparer should not file Paul's return without Form W-2.

Rejected Returns

The IRS may reject a return submitted through e-file. In many cases, the ERO or preparer can rectify the reject quickly. If the reject cannot be resolved, the ERO must take reasonable steps to inform the taxpayer of the reject within 24 hours and provide the reject codes to the taxpayer. At such times if the taxpayer chooses to not have the return retransmitted, or if the IRS cannot accept the return, the return must be paper filed by the due date of the return or 10 calendar days after the rejection is issued. A statement should be attached to the return explaining why the return is being filed past the return due date and noting that the return was originally timely filed.

Example:

Fred has his Form 1040 prepared and e-filed by his local tax return preparer on April 15, 2025. The preparer contacted him on April 16 and explained the return had been rejected by the IRS. The reject code referred to his dependent and the tax return preparer told Fred his son had already been claimed as dependent on someone else's return. Because Fred's son was not eligible to be anyone else's dependent, Fred wanted to paper-file the return. Since the due date of the return had passed, but the return was

filed timely initially, Fred must attach a statement to the paper return explaining the rejection and noting the original date the preparer attempted to e-file the return.

3.7 Annual Filing Season Program (AFSP) (Rev. Proc. 2014-42) (Pub. 5227) (Pub 5646)

The Annual Filing Season Program is intended to recognize and encourage the voluntary efforts of non-credentialed tax return preparers to increase their knowledge and improve their filing season competency through continuing education. The program is not directed at or necessary for credentialed preparers such as attorneys, CPAs, enrolled agents, enrolled retirement plan agents or enrolled actuaries. They are already in possession of higher-level qualifications.

The Annual Filing Season Program (AFSP) is a voluntary program which aims to recognize non-credentialed tax return preparers who aspire to a higher level of professionalism. Tax return preparers who complete the requirements of the program earn the AFSP – Record of Completion. Preparers who complete all the requirements are also included in the IRS Directory of Tax Return Preparers and Select Qualifications, where taxpayers can search for qualified tax return preparers in their area.

The directory includes the name, city, state, ZIP Code, and credentials of all attorneys, certified public accountants (CPAs), enrolled agents, enrolled retirement plan agents (ERPAs), and enrolled actuaries with valid PTINs. It also includes information on individuals who received an AFSP – Record of Completion.

Following the completion of all Continuing Education requirements and renewal of PTIN for the upcoming year, eligible return preparers will receive an email from the IRS. The email will provide instructions for

logging into your PTIN account and completing the process. Among the final steps will be a required consent to adhere to specific practice obligations outlined in Subpart B and section 10.51 of Treasury Department Circular No. 230. Following successful completion of these steps, you will be issued an Annual Filing Season Program - Record of Completion.

Please note that it may take up to four weeks following the completion of all requirements for return preparers to receive a Record of Completion and be placed on the Directory of Federal Tax Return Preparers with Credentials and Select Qualifications. Additionally, you will not be issued a Record of Completion until your PTIN is renewed for the upcoming tax year.

3.7.1 AFSP Requirements

To earn the AFSP – Record of Completion for the 2024 filing season, participants must:

- a) Obtain necessary continuing education before December 31, 2024, including:
 - * A six-hour Annual Federal Tax Refresher (AFTR) course and exam
 - * Ten hours of other federal tax law topics
 - * Two hours of ethics
- b) Have an active PTIN for the year of participation.
- c) Consent to adhere to specific obligations in Subpart B and Section 10.51 of Circular 230

Some preparers may be exempt from the AFTR course. Publication 5227 outlines all the requirements as well as the exemptions from the AFTR course. Please note that Enrolled Agents are not allowed to earn CE credit for the AFTR course. For more information, see Publication 5227.

Continuing Education for the AFSP

The continuing education credits required to earn an Annual Filing Season Program (AFSP) Record of Completion are displayed in the following table.

AFSP Exemption				
Status	AFTR Course & Exam	Tax Law + Update Federal	Ethic	Total CE
Non-Exempt	6	10	2	18
Exempt		13	2	15

Other tax return preparers who desire to earn an AFSP Record of Completion must complete the CE listed in the Nonexempt row of the table unless they are exempt from the Annual Federal Tax Refresher (AFTR) course and test requirement. If that is the case, they must complete the CE requirements listed in the “Exempt” row of the table.

Preparers Exempt from the AFTR

The following unenrolled preparers are exempt from the AFTR course and test requirement because they have passed other recognized state or national competency tests covering federal tax matters:

- RTRPs: Anyone who passed the Registered Tax Return Preparer (RTRP) test administered by the IRS between November 2011 and January 2013
- Participants in established state-based return preparer program with testing requirements: Return preparers who are active members of the Oregon Board of Tax Practitioners and the California Tax Education Council, and return preparers who pass the examination of the Maryland Board of Individual Tax Preparers (when available)
- SEE Part I test-passers: Tax practitioners who have passed the Special Enrollment Exam (SEE) Part I within the past two years, as of the first day of the upcoming filing season
- VITA volunteers: Quality Volunteer Income Tax Assistance (VITA) program reviewers and instructors with active PTINs
- Other accredited tax-focused credential-holders: Tax practitioners who have passed the Accredited Business Accountant/Advisor (ABA) exam or the Accredited Tax Preparer (ATP) exam offered by the Accreditation Council for Accountancy and Taxation

3.7.2 Circular 230 and consent to be subject to Circular 230 rules

AFSP participants are required to consent to adhere to certain provisions of Circular 230. Before the AFSP Record of Completion is issued, participants are required to consent to the following statement:

“I agree to abide by the duties and restrictions relating to practice before the IRS in subpart B and section 10.51 of Treasury Department Circular No. 230 for the entire period covered by the Record of Completion”.

“I understand that failing to comply with the duties and restrictions relating to practice before the IRS in these sections may result in the revocation of my Annual Filing Season Program – Record of Completion, and I may be prohibited from participating in the Annual Filing Season Program in the future.”

After all other requirements have been met for the AFSP, participants will receive notification in their secure online PTIN mailbox with instructions on how to sign the Circular 230 consent and receive the AFSP – Record of Completion.

3.7.2 Limited Representation Rights

Tax professionals who are not CPAs, EAs, or attorneys, but who participate in the AFSP have limited representation rights. Return preparers who have limited representation rights can represent only those clients whose returns they prepared and signed, but before only revenue agents, customer service representatives, and similar IRS employees (including the Taxpayer Advocate Service).

3.7.3 Limited representation

Tax return preparers who have an active PTIN, but no credentials and do not participate in the AFSP, can prepare and sign tax returns, but have no representation rights. These preparers have no authority to represent clients before the IRS (except for returns they prepared and signed before December 31, 2015.)

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